2012 Market Update

propertysecrets
unveiling the truths of property investment

By Alan Forsyth

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Foreword

By Alan Forsyth

Hi,

Hope you are well – and have had a good 2011! Here at Property Secrets we have had our busiest year for 5 years, and sourced over 500 properties for clients – as well as increasing our own portfolios.

Alan Forsyth

How do we see 2012?

So how do we see 2012 for property investors?

We end 2011 pretty strongly considering the doom and gloom all around us economically, with house prices, according to Nationwide; going up 0.4% in November to £165,798 and mortgages at a 2 year high.

When looking at how we predict house price trends for 2012, there are 4 key influences to review – that will have the major influences on house prices in the UK.

1. **Supply of finance/credit and at what interest rates** – easily available credit leads to prices rising – and is more likely to lead to an unrealistic growth in prices. When credit is less easily available then prices can stay flat or even go down.
2. **Employment** – clearly if people are not in employment it is much harder for them to get a mortgage, and if people are concerned about their employment prospects they are less likely to commit to a move, or to take on a bigger mortgage – which can lead to prices falling or staying flat. A buoyant employment market can lead to price rises.
3. **Supply and demand of new properties** – clearly if the supply outweighs demand, this can mean the average price drops. Vice versa if supply is lower than demand this puts upward pressure on prices. So the supply of new properties coming on the market in 2012 can make a significant difference to the values of property. Likewise the demand will clearly make a big difference and the size of the population and whether this grows or reduces clearly can impact house price levels.
4. **Alternative Investments** – the performance of other investments will have an impact on the property investment market – as if investors can see strong returns in the stock market, or via other investment vehicles, more funds shall go into these rather than the property market. On the flip side when alternative investments show unreliable returns more people will invest in bricks and mortar.

Let’s look at each of these individually.

Supply of Finance & Borrowing Rates

The introduction of new lenders, as we expected has led to further competition and choices for buy to let investors – Aldermore, Paragon, Precise, Kensington have all taken on immediate market share. Whilst their criteria and products are based around a cautious lender attitude, it's a great sign for the buy to let market **and I expect further product improvements going into 2012 as the competition increases.**

The increase in mortgage products reveals that the increase in mortgage funding is going up. Borrowing from the BOE has been put aside in favour of banks offering customers competitive interest rates and offsetting this against high arrangement fees for mortgages. Whilst we complain about these arrangement fees, at present they are very important for bank funding. If a deal works, then most of us will be prepared to surrender to these high fees for a decent property on a low interest rate.

Newer lenders, plus well run smaller lenders and commercial lenders are coming in and offering flexibility, and taking market share.

The sign of lenders re-entering or newly entering the mortgage market and seeing an increase in the number of mortgage products available is clearly a positive.

The government in their November statement talked about setting up an underwriting scheme that will help up to 100,000 people get 95% mortgages on newly built homes. On paper this sounds great – we shall need to see how this pans out, but anything to assist those onto the housing ladder without overstretching themselves will be positive for the housing market.

For those of you who took advantage of the deals in 2011, you can be sure you have made a safe investment and you will continue to benefit from high cash flow from your low rates mortgages well into 2012.

Interest Rates

Interest rates have ended the year as they started – at just 0.5%, great news for investors on long term tracker mortgages.

The days of mortgage brokers trying to persuade borrowers to jump onto fixed term mortgages, before rates rise, seem a long time ago – although both tracker and fixed rates - mortgages are at their best rates for a long time – with more and more options at even under 4% interest. I have always felt interest rates would stay low far longer than many commentators said, and it has been good to see many now sharing this view.

There are various pressures to increase rates (such as inflation) but with the increased issues in the Eurozone in 2011, and the sluggish growth levels in the UK, with the threat of dropping back into recession still a possibility, the MPC (Monetary Policy Committee) will not want to expose our economy to these dangers any time soon.

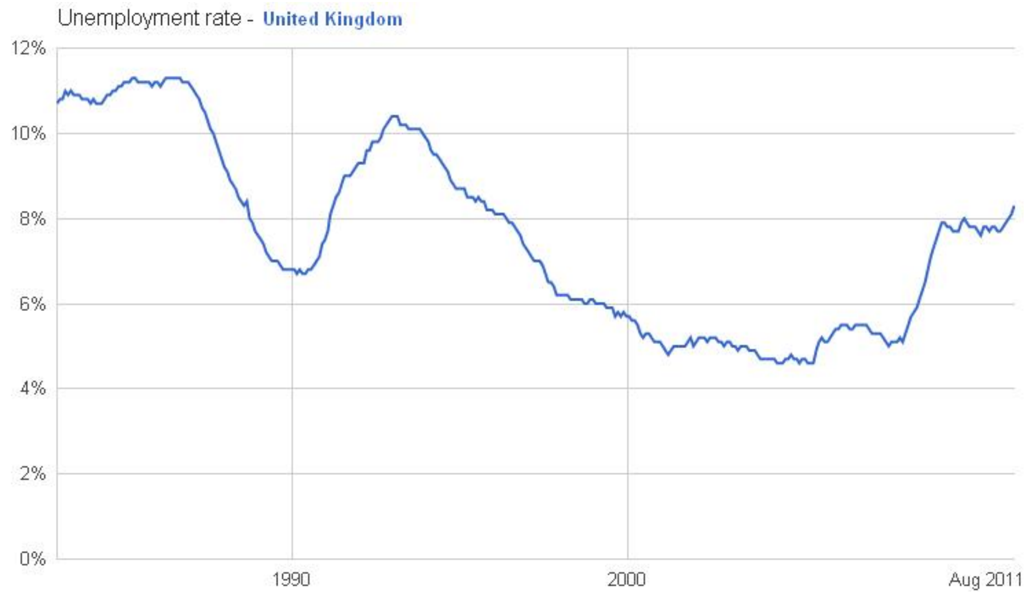
I now expect interest rates to stay under 1% until 2016, and borrowing rates to stay low over this period – fantastic news for all borrowers, and investors.

So overall, in conclusion on the first key influence on house prices in 2012, the availability of credit and borrowing rates as we end 2011 are more positive than the start of the year, and we fully expect this to continue into next year.

Employment

It is clear that job security and wage inflation can have an impact on house prices and values.

The latest figures are relatively weak. The early indications are that unemployment in the UK will rise over 2012.



UK unemployment rose by 128,000 in the three months to October 2011 to 2.64 million - the highest level since 1994, according to official figures. Since the start of the year when unemployment was 2.49mil, the overall number has risen by 150,000.

The Office for National Statistics (ONS) said the unemployment rate also increased to 8.3%, up from 7.9% in the previous quarter.

The unemployment total for 16-24 year olds hit a record high of 1.027 million in the quarter, beating the previous record set only last month.

The claimant count, the number of people out of work and claiming benefits, rose by 3,000 to 1.6 million in November, less than economists were expecting.

<u>Average Salaries</u>

Salaries as an average have increased by 1.4% in 2011 in the UK – however with inflation at 5% or higher, this has resulted in real terms of a pay cut of more than 3.5%.

The median salary for a full-time worker in the UK rose 1.4% in 2011 to £26,244, against a headline CPI inflation rate of 5% or higher, according to the Annual Survey of Hours and Earnings from the Office for National Statistics.

Overall earnings growth was even lower, with the average UK salary increasing just 0.5% on 2010 levels once part-time workers are included.

This was driven by a shift to part-time work as a result of high unemployment and low economic growth: the indicative figures for 2011 included 380,000 fewer full-time workers than a year before, with 72,000 more part-time employees.

So overall, considering the credit crunch, employment figures have stayed pretty resilient as can see over the last 12 months – however with public sector job cuts to come, many expect another 200,000 net jobs to go over the next 12 months.

It is fair to say that with pay inflation weak and public sector job cuts to come, there is unlikely to be upward pressure on house prices due to increasing salaries and increasing numbers of jobs – with the chance that with job cuts there could well be some downward pressure on prices in certain regions in 2012.

Supply & Demand of New Properties

The UK for years has struggled to build the target number of properties required each year. As a small island, and a growing population, the UK needs to build approximately 250,000 new houses each year just to keep up with demand from a growing population.

This has been made significantly worse by the credit crunch – as both end buyers and developers have been unable to make the figures work.

Developers **are sitting on land which has dropped in value by up to 60-70%**, and building on this will struggle to give end values that are supported by the banks and buy to let lenders – so they have no alternative but to sit on this land until values rise – and this could take 3-4 years.

So in the meantime houses and apartments are not built.

The change in government, and change in planning regulations and targets set by local government are also making a significant change to the number of houses being built.

Just 106,000 houses were built in England in the 12 months to September, according to official figures – **less than half the numbers needed** and down by 37.5% on the pre recession total.

The housebuilders are however seeing some improvements, with Barratt's reporting a 26% increase in weekly reservations during the autumn period. George Osborne has put infrastructure and housing at the centre of his growth plans – with a £400 mil fund to help developers re-activate stalled sites. The government has also talked about releasing enough brown-field land to build 83,500 homes and easing the planning burden on developers.

However, local authorities have ditched plans for 160,000 homes since the coalition government came to power, research has found, so we shall need to see actual figures over the next 12 months.

Indeed in 2011, research from Tetlow King Planning, for the National Housing Federation, suggest the number could reach between 280,000 and 300,000 by this time next year.

Since the planning changes were announced, almost 70 councils have halted progress on development plans, reduced previously planned housing numbers or delayed planning enquiries at appeal.

One of the other issues affecting nervous developers, apart from planning, and overpriced land banks, is not finding buyers, but finding buyers that can get finance.

Crest Nicholson recently stated that they felt they could achieve “30% more homes if the mortgage market was more relaxed”. As highlighted above, we are hoping this improves going forward.

Research released in 2011 by the think tank IPPR painted a gloomy picture of house shortages in England **growing disturbingly in the years to 2025, by which time it reckons we could have demand outstripping supply by 750,000 homes.**

This prediction is based on the population continuing to grow at current levels, and also bases the 750,000 number on the rate of stock increase being 160,000 a year – the average over the past two decades. 2010 saw 129,000 new houses, and 2011 as stated around 106,000 have been built.

So potentially this shortfall could increase by even more. Plenty of people fear it will be a long time before we build enough homes to boost stocks that much annually. Indeed, house builders have rebased their businesses for now to build far fewer homes annually. Of course we expect credit to keep improving, which should lead to more demand, but this shows the uphill struggle to keep up with demand.

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Latest Predictions for UK population

According to the government national statistics, the UK population is projected to increase by 4.3 million by 2018. This increase is equivalent to an average annual rate of growth of 0.7 per cent, or 450,000 people every year – so even keeping up with the growing population, never mind replacing existing houses, we need hundreds of thousands of houses each year to house everyone.

If past trends continue, the population will continue to grow, reaching 71.6 million by 2033. This is due to natural increase (more births than deaths) and because it is assumed there will be more immigrants than emigrants (a net inward flow of migrants).

In common with other European countries, the UK has an ageing population. The proportion of people aged 65 and over is projected to increase from 16 per cent in 2008 to 23 per cent by 2033. This is an inevitable consequence of the age structure of the population alive today, in particular the ageing of the large numbers of people born after the Second World War and during the 1960s baby boom.

Projections of households for England published by the Office of the Deputy Prime Minister (ODPM) on 14 March 2006[1] estimate that 4.8 million new households will form between 2003 and 2026, an annual growth of 209,000, down to the reasons highlighted above, as well as more single households expected – see below.

Immigration	32%
More adults	28%
More single households	21%
More pensioners	19%

So all 3 indicators here – planning changes by the current government, lack of incentive for developers to profitability build new houses currently, and a population growing by almost half a million each year – means demand is going to continue to exceed supply suggesting upward pressure on prices, in particular in larger cities and towns, with affordable prices i.e. prices with low ratio to current salaries.

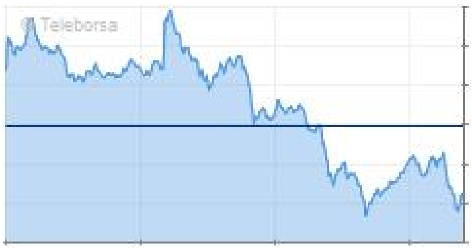
The South East of the country also continues to see huge demand due to the shortage of housing and the large density of population.

Alternative Investments

The performance of other investments will have an impact on the investment market – as if investors can see strong returns in the stock market, or via other investment vehicles, more funds shall go into these.

With everyone now aware they will have to work longer i.e. to a higher age, as we are all living longer, people are more aware of investing for the future.

So how has the stock market performed, which pretty much dictates most pension schemes?



Well in 2010 and the first part of 2011, it had bounced back and was looking good, with potentially very strong returns. Indeed, up until the start of this year, the bulls were in the ascendency on an incredible run. The FTSE 100 total rally to the mid-February 2011 high of 6091, represented a 73% recovery from the low of 3512 in March 2009.

The second half of 2011, has been a different story, and showed just how vulnerable investing in the stock market can be, with fears over European countries' finances, started by the issues in Greece, and continuing to spread across Europe, and the concerns over the continued levels of bad debt – with several countries in effect bankrupt. European and US banks and governments still have an unquantifiable and potentially lethal level of bad debt.

In one week in August alone the FTSE lost 10% of value.

Several leading experts, including Merryn Somerset Webb and Andrew Oxlade of Moneyweek, who predicts the FTSE 100 could be at the same level in 2020, and respected analyst Jeremy Grantham believe the FTSE 100 is overpriced by between 30-40%.

Matthew Vincent of the FT states that the FTSE would not be good value until reaches 3900.

Andrew Oxlade, states that the FTSE 100 returned a total of a little less than 7% in total over the whole decade 2000-10.

With the uncertainty in the stock market, many investors have pulled their funds out, quite understandably, and taken control of their own destiny by buying into buy to let properties in the UK. By buying a good sensible UK rental property for under £100,000 with a strong amount of equity on day one, protecting you from further falls, and giving 8% plus rental returns investors are feeling in more control of their future, and getting a more reliable return on their funds.

Saving Accounts

With interest rates continuing to stay low and yet inflation high, people holding their money in the bank are worse off at the end of 2011, compared to the start of the year. Clearly this is not an attractive proposition – again leading to many looking for alternative ways to get a financial return.

We have seen therefore many take control of their own destiny by buying into buy to let properties in the UK. By buying a good sensible UK rental property for under £100,000 with a strong amount of equity on day one, protecting you from further falls, and giving 8% plus rental returns investors are feeling in more control of their future, and getting a more reliable return on their funds. Indeed many worldwide investors are pulling funds out, and buying properties for cash in what are considered safe havens – and the UK property market has benefitted greatly from this.

The statistics are very significant, with up to 40% of property transactions in London to cash buyers.

We have personally seen this with over 25% of our clients in 2011 coming from ex-pat Brits or foreign investors, with buyers from South Africa, Brazil, Canada, Australia, Asia, Middle East and all over Europe.

I do not envisage this changing in 2012 – with large sums of money continuing to enter the UK property market. While a lot will go into the South East of the country, many are also attracted by the 10% rental yields further north in the country where prices are incredibly cheap compared to rental returns.

So with alternative investments showing far less reliability than UK buy to let property in 2011, this has led many new investors to look towards buy to let property.

This shall continue as a positive in terms of house prices in 2012.

Summary

So we have an interesting mix of potentially positive and negative news here for 2012.

The major positives are:

- The mortgage market is continuing to develop – with several new lenders entering in 2011 and the introduction of higher LTV mortgage products.
- The supply of new housing is still a long way from coping with the demand of housing from an increasing population, and with more single person households.
- Huge external interest in the UK property market in 2011, and many new buyers who have been let down by the stock market/traditional pensions and saving accounts.

The major negatives are:

- Job cuts, in particular in public sector jobs, with cuts due to continue over the next 3 years, leading to an overall higher percentage of unemployed in the UK.
- Pressure on earnings – with pay increases not covering current inflation levels

So how does this leave things overall?

Well with house prices overall staying fairly consistent in 2011, albeit far less transactions than the peak, I think the various upward and downward pressures highlighted above will keep things pretty flat again in 2012. It would seem likely that regions that see the least amount of public sector job cuts, and the most private sector investment will likely perform best – which is currently the South East of England.

Buying properties that fit the first time buyer, single person household, and buy to let market will likely perform well in 2012, and continue the trend of 2011 ie giving some of the best returns on investment and the most reliable yields on an annual basis.

As buy to let investors, as significant as the house price trends, is the likely rental yields.

They are driven by many of the same influences as above.

One of the big positives to come out of the changes in the finance markets, the increasing number of single person households and the lack of new houses coming onto the market is that the rental market has continued to go from strength to strength.

<u>Rental Demand Continues to go from Strength to Strength</u>

A residential lettings survey from the Royal Institution of Chartered Surveyors (Rics) showed 19pc more property agents reported that rents rose rather than fell, although the pace of growth moderated from earlier in the year.

Demand in the rental market has been driven by the difficulties highlighted above, lack of choice still of mortgages, and lack of housing coming onto the market..

This is the seventh consecutive quarterly increase, reflecting the imbalance between demand and supply.

Rents in London, as expected were found to have increased at the fastest pace, but they continued to rise in the North, the South East, the Midlands, Scotland and Wales.

Lettings agent Countrywide says soaring demand for rental property means homes are being let in record time, and it has five prospective tenants for every available home, despite a marginal increase in the number of properties available. And this is not just an issue in London and the south-east, or a problem confined to urban areas.

Halifax state that the average monthly rent across the UK has risen to £722. Meanwhile, what it describes as the average monthly buying cost (mortgage payments plus insurance and other costs) has fallen to £600.

In terms of monthly costs, owning a home is now typically 17% cheaper than renting, claims the Halifax.

All of this is great news for buy to let landlords, and confirms our thoughts, that even with 1 million more people losing their jobs over the last 3 years in the UK, due to the lack of housing and the growing population the rental market will continue to perform very well.

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Conclusion

So overall who is this good news for?

Well for those with good credit history, that can get approved for mortgages, and have funds in place for buying costs and deposits I firmly believe 2012 will be one of the best times in the last 10 years to be buying properties for buy to let, potentially even better than last year as all the evidence indicates some of the best rental returns for years, alongside some pretty attractive borrowing rates – and personally we shall continue to add to our portfolios.

By putting in aggressive bids, you can get properties for 2005 values, and rents have increased by around 20% since then! So yields are excellent and positive cashflow is very healthy.

For those looking to buy to sell as an investment choice, it still is difficult, but again if can get very strong discounts, and buy in a desirable area and add some value, then is still possible to buy and sell – especially if can move quickly.

Recent and current examples of deals we have secured for clients include:

- **3 bed family houses at 35% below current valuations**
- **Tenanted property in Cumbria giving 12% rental returns**
- **New build family 4 bed houses at under £100,000**

If you would like to speak to us, to find out more about buying investment properties in areas providing very strong yields and at healthy discounts, you can call us on 0115 9853963 or email us at service@propertysecrets.net

We currently work with over 1000 clients building up portfolios for them from 1-10 properties all producing positive cashflow on a monthly basis. Over 100,000 investors subscribe to our weekly newsletter – sign up for free at www.propertysecrets.net

Best Regards

Alan Forsyth