INVESTING IN UK PROPERTY IN 2016

WHY FORTUNE FAVOURS THE WELL-INFORMED

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Britain's property market is facing some of the biggest changes it has seen in a decade, with a raft of new rules set to impact second home and buy-to-let buyers. Yet amid the overhaul, there are opportunities aplenty for astute investors.

This report sets out what you need to know to keep one step ahead of the changes – and how to make well informed property investment decisions in 2016.

Jonathan Hopper – Managing Director

There is already evidence of buying activity in the first quarter as both buy-to-let investors and second homebuyers rush to complete before April's Stamp Duty increase.

Thereafter the field will increasingly be left to the more sophisticated buyers or institutional investors who have the resources, expertise and ability to take the changes in their stride.

For investors who equip themselves with the right intelligent and advice, 2016 and beyond promise to offer great opportunity.

VIEW FROM THE FRONT LINE

British investors have long regarded residential property as not just the most tangible asset class, but also one of the most consistent.

2015 reinforced this popular appeal – with average house prices rising across the UK, and annual rates of price growth in hotspots like London, Oxford and Cambridge reaching double figures.

Hundreds of thousands of property investors have reaped the rewards of rising prices, and there has been a boom in buy-to-let investing. The government's latest Housing Survey revealed that in England alone, buy-to-let landlords own 4.4 million homes – enjoying not just capital appreciation but rental income too.

But the buy-to-let bandwagon could stop in its tracks in 2016. Major changes announced late last year by the government are already altering the shape of both the buy-to-let and second-home markets. They are summarised in the following table:

With as many as two million Britons now owning a buy-to-let property, the Bank of England is warning that the sector's size could "amplify" a housing boom or bust. These measures, announced in quick succession, have prompted some to see the government as being anti-buy-to-let.

Certainly buy-to-let investors will be hit much harder than buyers of second homes – for whom the changes are likely to be an awkward speed bump rather than a gamechanger.

But for the buy-to-let sector it will be a different matter. It's likely that many small investors, and especially those who are highly leveraged, will exit the market.

This in turn should create substantial opportunities for more sophisticated investors. With many tenanted properties likely to come up for sale just as competition from small landlords wanes conditions will be ripe for wealthier, less credit-reliant investors to increase their rental portfolio.

CHANGE	WHO WILL BE AFFECTED	TIME FRAME
3% increase in Stamp Duty on purchases of "additional residential properties"	Buyers of second homes or buy-to-let property	Effective 1st April 2016
Cut in tax relief on buy-to-let landlords' mortgage interest payments	Higher rate taxpayers who own a mortgaged buy-to-let property – the tax relief they can claim on their mortgage interest payments will be limited to 20%	Phased in from 2017 to 2020
Bank of England to be given broader powers to restrict buy-to-let mortgage lending	Buy-to-let buyers seeking a mortgage would face greater scrutiny of their finances, and lenders may be limited to lending less	Public consultation is due to complete in March 2016
Capital Gains Tax will have to be paid within 30 days of the sale of a residential property, down from the current window of up to 22 months	Those selling a property that is not their primary residence	Effective April 2019

BUY-TO-LET WINNERS & LOSERS

With buy-to-let landlords facing both a stamp duty levy, loss of mortgage interest tax relief and restrictions on mortgages in 2016, a series of alternative ownership structures is emerging to allow the financially astute to continue to enjoy the market's robust returns.

Buy-to-let property investors might be forgiven for feeling under siege following the government's most recent Autumn Statement.

Though the slew of measures impacting property investors was presented by the Chancellor as a "levelling of the playing field" between those buying a home and BTL buyers, the slashing of the tax relief landlords can claim on their mortgage interest payments is also astute politics.

For the Exchequer it will be both a substantial revenue raiser, and a tax grab on landlords for whom many voters may feel little sympathy.

Together with April's 3% hike in the Stamp Duty levied on buy-to-let properties, it will hit smaller, highly-leveraged landlords hard. The resulting reduction in yield, plus the looming prospect of a rise in interest rates, will force many amateur and highly-leveraged landlords to exit the market.

Would-be buy-to-let owners seeking a mortgage may also face tougher borrowing criteria following a public consultation on whether to give the Bank of England new powers to rein in lending.

But if smaller buy-to-let investors are the losers of this double-whammy of tax revisions and lending restrictions, more sophisticated investors could be big winners.

The exit of smaller BTL investors from the market will create an unprecedented opportunity for wealthier investors – as a spike in the supply of tenanted properties for sale coincides with less competition from inexperienced buyers.

Far from creating a rental crisis, this will allow institutional and sophisticated investors to step in and take up the slack left by smaller players forced out of the market.

Family offices and HNW investors are at the vanguard of this change, and are already using an exciting new range of ownership structures to limit their tax exposure, such as:

LIMITED COMPANIES – this is likely to become the new norm for sophisticated investors buying property. Properties held in a corporate vehicle will continue to benefit from full tax relief on mortgage interest payments and from 2017 enjoy lower rates of corporation tax.

PROPERTY SYNDICATES – these allow a group of investors to combine their funds to make a collective investment in property. Investors pay income tax on their net rental income, and CGT if the property is sold for a profit.

PROPERTY CROWDFUNDING – a new breed of crowdfunding platforms allows investors to buy shares in individual BTL properties. Shareholders get a portion of the rental income and can sell their stake if they want to realise the value of their asset. There is no Stamp Duty to pay when investing, but investors must pay income tax on the rental income, and CGT on any gain made when the property is sold.

The government is keen to get more owner-occupiers onto the housing ladder, and is doing so at the expense of the amateur buy-to-let sector.

So it's ironic that the moves it has unveiled to discourage smaller buy-to-let investors won't just create a gap for more sophisticated investors, they will also magnify their potential returns.

The Royal Institution of Chartered Surveyors predicts that over the next five years, rents will rise by an average of 5% a year – outpacing average price rises of 4.7% a year.

Against this backdrop, 2016 is likely to offer exceptional opportunities for astute buy-to-let investors. But the challenges posed by tax rises and lending restrictions will also raise the stakes for those making critical investment decisions.

So the need for first-class market intelligence and expert counsel is now greater than ever.

HM Revenue & Customs

HIGHER RATES OF STAMP DUTY LAND TAX (SDLT) ON PURCHASES OF ADDITIONAL RESIDENTIAL PROPERTIES

From the 1st April 2016 liability to pay a higher rate of SDLT is proposed to be determined as follows:

How many properties do you own at the end of the day of the transaction?

ONE The transaction is not subject to the higher rates, regardless of what the property is used for.

TWO+ Is the property being purchased replacing your main residence (which is being sold)?

YES The transaction is not subject to the higher rates.

YES, but previous main residence has not yet been sold. The transaction is subject to the higher rates; but a refund is available if the previous main residence is sold within 18 months.

NO The transaction is subject to the higher rates.

Source: HM Treasury

HIGHER RATE SDLT

Proposed new rates applying to additional residential properties purchased in England, Wales and Northern Ireland after 1 April 2016.

Band	Old	New
£0 - £125k	0%	3%*
£125k - £250k	2%	5%
£250k - £925k	5%	8%
£925 - £1.5m	10%	13%
£1.5m +	12%	15%

Source: HM Treasury

*From £40,000

HOW TO MAKE THE SECOND HOME SUMS ADD UP

With the potential for double-digit rental yields, strong capital growth and the promise of blissful family holidays, the dream of a second home is as compelling as ever - but April's stamp duty hike means the dream will come with a higher financial cost.

Whether it's a bolthole in the heart of the Cotswolds, a seaside cottage in Devon or a city pied-a-terre, there are certain boxes that prospective buyers always seek to tick when searching for that dream second home.

Location, character, transport links, length of tourist season and resale potential are all checklist staples, as is a good sense of community. Even a picture postcard cottage may lose its lustre if it's in a 'second-home ghetto' – an area that's deserted out of season because the locals have all been priced out.

But if buyers' individual wishlists are infinitely varied, their motivations are often similar - a complex cocktail of head and heart.

For most, the genesis of wanting a second home is often a holiday, or a stay in a friend's house, in an area that they fall in love with. That initial, emotion-led idea – "wouldn't it be nice to have a place here?" – is then layered over with more practical and financial considerations.

For the right property in the right location, the financial case can be strong.

Second homes in desirable areas – especially those with limited supply - can enjoy strong capital growth, well beyond the county average.

If you are willing to let out your second home while you're not staying there, the rental yields in the most desirable locations can run into double-digits – more than double what a typical buy-to-let property might earn.

But second home purchases are never driven by purely financial factors. The most fundamental question buyers ask themselves tends to be "is this somewhere I will want to come back to regularly for my holidays?"

Some buyers will happily sacrifice a degree of rental yield in order to secure the dream property. The overarching vision that most will have is of a peaceful retreat that will both be a venue for many happy holidays, and a legacy they can leave their children.

Following the shake-up in stamp duty at the end of 2014, many buyers looking for their ideal second home 'away from it all' changed strategy – either scaling down in size or by looking beyond the traditional favourite locations.

Buyers are increasingly weighing up second home hotspots – such as the Lake District, Devon, Cornwall, the Norfolk and Suffolk Coasts, West Wales and West Sussex – against the better value available in North Yorkshire, Cumbria and the Scottish Highlands.

Yet the challenge for those trying to stay ahead of the geographic curve is to identify which areas still have the potential to show disproportionate growth – in other words, where might the next 'Rick Stein effect' be?

The combination of greater competition for the best value second homes and the cost implications of this April's stamp duty increase – which will see the duty on second homes rise by a further 3% – mean it is more important than ever for buyers to use their head more than their heart.

In short, the stakes are now far too high to impulse buy following a sunny weekend away. Wise buyers appreciate the need for the right intelligence to make the right decision.

And remember, the time of the year when you buy can be important, too. The canniest buyers often seek to purchase their second home during the less popular winter months – before the sun causes prices to bloom as much as the roses in that dream summer garden.

MAPPING THE ROUTE TO RETURNS

Smart investors are adapting their buying strategies in response to the changing property landscape, where enticing returns still remain available – however, identifying the right opportunity, more than ever, requires the right market intelligence.

2015 was the year that the remorselessly rising prices of super-prime London property finally took a breather. The introduction of punitive levels of stamp duty and a collapse in oil prices caused the global super-rich to reassess their approach to Britain's most expensive property. In most cases, demand and prices both fell.

But for most of the UK property market, the only way was up. According to the Halifax, average prices rose by a brisk 9.5% during the year. The Royal Institution of Chartered Surveyors is predicting the momentum will continue into 2016, with average prices rising by a further 6% nationwide.

Such robust price growth alone is enough to make property an attractive investment, but with the first weeks of 2016 being marked by tumbling stock markets and an admission from the Bank of England that interest rates will stay at rock bottom levels for much of the year, at present neither equities nor cash look likely to match the perennial lure of property as an investment.

Property investors typically seek either capital growth or rental yield – or a combination of the two. Research and market intelligence from Garrington has identified the following areas as having the greatest potential in these three investment categories.

Best for capital growth

Cambridge – Prices in Cambridge leapt by a breathtaking 14.4% in 2015, outstripping even those in London. With good links to London, a shortage of land in the city centre and a booming knowledge-driven economy, Cambridge is likely to outperform once again in 2016.

Oxford – The city now boasts two train lines to London and good connections to the Midlands and the North. With a shortage of available land, a strong biotech industry and demand consistently outstripping supply, Oxford's growth prospects remain robust.

Home Counties – The classic London overspill areas are perfectly positioned to appeal to young professionals priced out of the capital, as well as those seeking country living within commuting distance. The RICS predicts that prices in South East England will rise by 7% in 2016 – ahead of London's 5%.

Other locations to consider include Bristol, Guildford, York and Exeter.

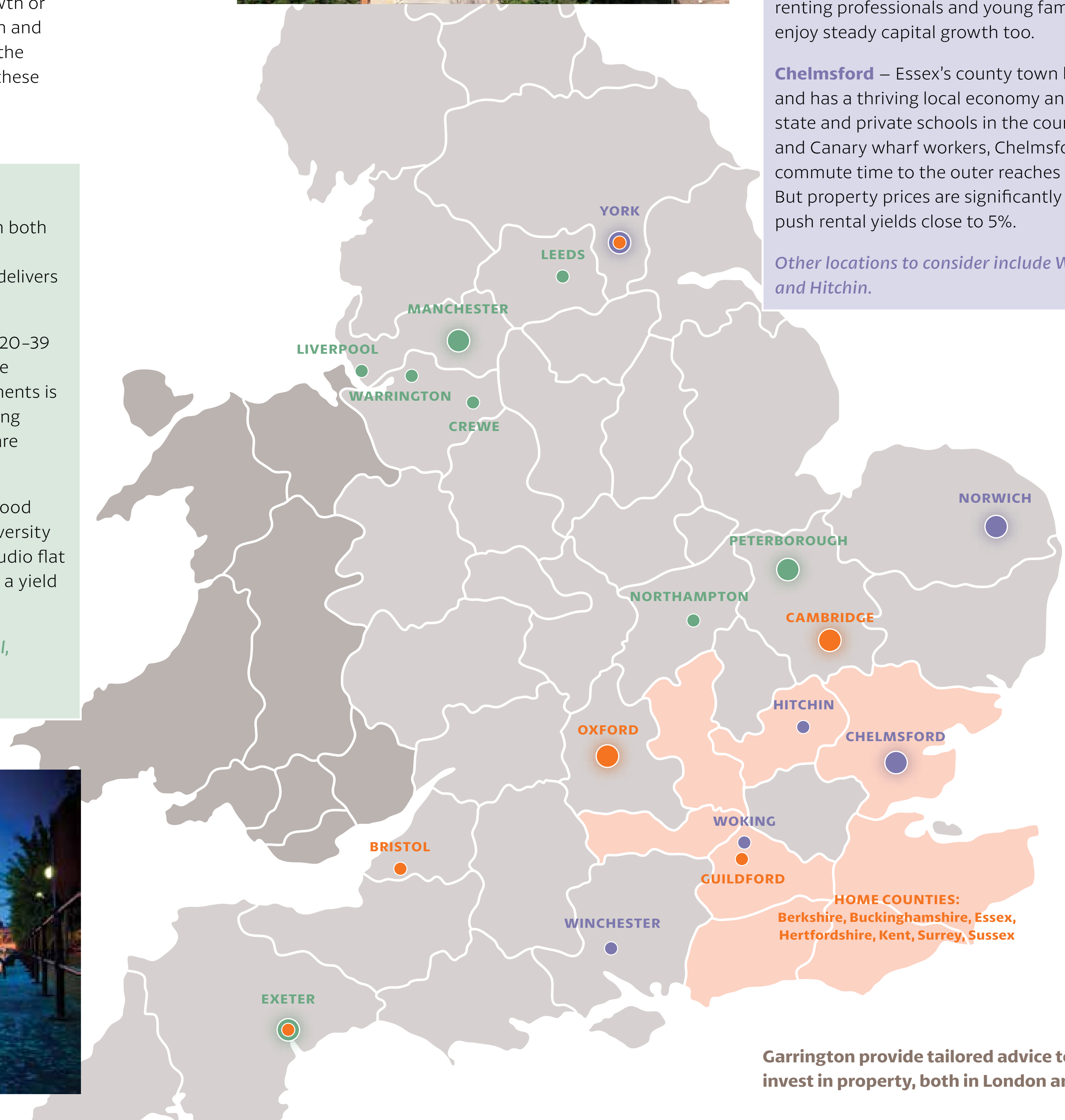
Best for yield

Peterborough – With strong rental demand from both professionals and Eastern European workers, Peterborough has proven buy-to-let appeal and delivers gross yields of around 8%.

Manchester – In the past decade the number of 20-39 years olds living in the city has nearly doubled. The purchase price of one- and two-bedroom apartments is still relatively low, but constant demand from young professionals and students ensures rental yields are strong and rising.

Exeter – Student accommodation can provide good investment opportunities in Exeter, with the University drawing more than 20,000 students a year. A studio flat can be purchased for just over £80,000, offering a yield upwards of 7%.

Other locations to consider include Leeds, Liverpool, Northampton, Crewe and Warrington.



Best for blended returns

Norwich – While not matching Cambridge for capital growth, prices are rising steadily and rental yields of 6% are still achievable. With strong rental demand from young professionals, freehold terraces in particular offer the potential for both appreciation and constant rental returns.

York – The Clementhorpe area offers a sweet spot of investment opportunity. With lots of independent shops and a strong community feel, it's within walking distance of the city centre. Terraced houses here will appeal to renting professionals and young families, and should enjoy steady capital growth too.

Chelmsford – Essex's county town became a city in 2012, and has a thriving local economy and some of the best state and private schools in the country. Popular with City and Canary wharf workers, Chelmsford has a similar commute time to the outer reaches of the Central Line. But property prices are significantly cheaper here, helping push rental yields close to 5%.

Other locations to consider include Winchester, Woking and Hitchin.

Garrington provide tailored advice to clients wishing to invest in property, both in London and throughout the UK.

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