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WILL 2017 BE THE STRAW THAT BREAKS THE CAMEL'S BACK?

SARAH WALKER EXAMINES IN DETAIL

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MANAGING YOUR HMO: HOW BAD CAN IT REALLY BE?
Dan Allen takes an in-depth look.

THINGS YOU SHOULD DO IN DECEMBER
Matthew Moody looks at the end-of-year strategies.

COSTLY MISTAKES THAT CAN RUIN YOUR ROI
HMO Daddy lists 15 regular mistakes and how to avoid them.

What does 2017 hold for landlords and how could Brexit affect your HMO investment?

It's that time of year when the larger property companies make predictions for the market in the forthcoming year and we, as investors, review our own future plans and financial projections in the light of those forecasts.

So what do the experts predict that 2017 will hold for HMO landlords?

Capital values

In terms of UK price predictions, two of the three main property research analysts, Savills and Countrywide, suggest that the market will not grow overall. Savills predicts small rises in the South East, South West and East of England, with London and the East Midlands remaining flat and everywhere else experiencing small falls. Countrywide is being slightly more pessimistic, forecasting that everywhere in England and Wales will experience slight falls (from -0.25% in the North to -1.3% in London) and that prices in Scotland will stay as they are.

Knight Frank, on the other hand, has been far more optimistic, predicting that every area in the UK will see property price rises – of between 2% in the North West and 4.5% in London - giving an overall UK average increase of 4.1%. Given that each of these companies has access to the same data, it would appear that Knight Frank's analysts simply feel that there is more confidence among consumers than Savills' and Countrywide's do.

Looking beyond 2017, both Savills and Knight Frank are forecasting price rises of 13% and 20% respectively, over the next five years overall; Knight Frank showing every area with double-digit increases. So the medium term does look reasonable, with those predicted rises staying slightly in front of inflation, which Capital Economics is forecasting to increase from its current low rate of 0.9% to 2.2%.

The impact of Brexit

The continuing lack of clarity about exactly what Brexit will mean for the UK is a big reason why experts are predicting the property market will experience no or negative growth in the short term. Economic uncertainty has a huge effect on prices because it affects people's confidence. When times ahead are unclear and people worry about jobs and income, they tend to batten down the hatches, resulting in a drop in the number of properties coming to the market, a drop in the number of available buyers and an unwillingness among the buyers who are out there to pay full asking price, as they fear a fall in house values.

All this means that if you are looking to expand your portfolio, the next 12 months could offer some very good opportunities for buying at a discount from those people who need to sell. That could also put you in a position to improve your average yield, as rents don't tend to drop in the same way as capital values. The caveat to that is that it depends on exactly where you are investing and the specific local market forces.

That's the impact on capital values, but what about the potential effect of Brexit on demand and rental income? There have been 'scare stories' about huge numbers of foreign workers, particularly those from Eastern Europe, leaving the UK and therefore many HMO landlords losing a significant proportion of their tenant base.

This is when we need to take a step back and look at some fundamentals. First, are immigrants really leaving in droves? There is still a great demand from UK employers for Eastern European workers, who are viewed as reliable and hard working. Secondly, even if many do leave, the issue of a lack of affordable housing remains significant and, assuming you bought your HMO in an area where there is solid demand for this kind of accommodation, you should still be able to fill your rooms.

However, rents are where you may need to do some forward planning. Given that inflation is forecasted to rise to 2.2% in 2017, even if wages continue to grow at their recent rate of 2.9% year on year (figure from the ONS), it isn't

giving tenants much room to be able to afford to pay more. That means increasing rents in line with inflation may not be possible, so it's unlikely you will be able to simply put rents up to compensate you for the forthcoming changes in taxation.

What the industry is saying about Brexit, a couple of months in...

ARLA says the rental market "keeps a face of calm amid Brexit storm" and that 77% of rents have remained unchanged. 64% of its member agents reported there has also been no change in tenant demand.

Meanwhile, SpareRoom's latest report suggests that some HMO landlords are seeing falls in room rent rates with plenty of supply on the market versus demand. Where rents are rising, average levels are not as high for rooms as they are for properties being let as a whole.

Legislation

The announcement in the Chancellor's recent Autumn Statement that letting agents will no longer be able to charge fees to tenants is not good news, as that cost is almost certainly going to be passed on to landlords. While the vast majority of HMO landlords will probably not feel any direct impact on their costs, as they self-manage already, this is a clear indication that Theresa May's Government is continuing the previous administration's attitude towards landlords. That means it is almost a foregone conclusion that nothing will be done to halt the implementation of the phased reduction of tax relief, beginning in April 2017 – especially in light of the High Court's recent rejection of a Judicial Review over the legislation.

Islay Robinson, CEO of high net worth London mortgage brokerage firm Enness Private Clients, comments on the Autumn Statement: "Would-be landlords have already been discouraged from entering the market, thanks to the extra 3% stamp duty incurred on buy-to-let properties and reduced tax allowances, and this is a move which further deters this type of investment. It is not welcome news and creates a false economy. Not only will it deter investors from entering the buy-to-let market, leading to a reduction in much-needed stock levels, but the tenant will be unlikely to benefit from this 'saving' in the long run, because the landlord will likely increase rental values in order to cover this fee."

What the industry is predicting for landlords, given the incoming legislative changes...

Research carried out by the National Landlords Association suggests that more than 400,000 basic-rate as well as higher-rate tax payers will suffer from the reduction in the level of mortgage interest relief. It predicts that landlords investing in Central London, the East of England and the West Midlands could be hit hardest.

In terms of net income, a landlord survey from the Residential Landlords Association suggested that 68% of those who participated could end up seeing their profits fall by 20%.

So how is 2017 looking for HMO investors?

The reality is that it's impossible to say, but I think there are three likely scenarios:

It may be good news for HMO investors if a proportion of current landlords decide to exit the market (as they almost certainly will) because the supply of accommodation is likely to fall and therefore demand will increase. It could open up opportunities for expanding and diversifying your portfolio, perhaps picking up some single-let landlord sales, as the profits from your HMOs will enable you to 'ride the storm' and hold them until affordability once again improves for tenants and capital values rise. And if some of these exiting landlords have held their properties for some time, they may not have a very high mortgage on them and therefore be willing to accept a low offer just to offload an investment that's no longer working for them.

However, if a number of landlords decide to hold onto their current single lets and convert them into HMOs, and/or more property investors set up new HMOs, the trend seen by SpareRoom could carry on and rents in some areas could continue to decline.

The third option is that we don't see much change at all. If some landlords exit the market while others take the opportunity to invest, rents stabilise as wages grow more-or-less in line with inflation, and you are able to gradually build in steady rent increases and cost reductions over the next four years to compensate you for your increased tax bill.

Of course, do keep in mind that the property 'market' is made up of micro-markets and what you experience in the coming months may be quite different to what happens to the portfolios of investors in other areas.

Keep in touch with your local sales and letting agents and monitor prices and rents online to make sure you stay abreast of the latest trends but it's important to know that – as we learned from the credit crunch – the rental market is extremely resilient and tends to remain stable during times of economic uncertainty. Nevertheless, although your HMO portfolio should retain its capital value and continue to generate worthwhile returns, it's prudent to prepare yourself for your profits in 2017 not being quite at the level you've become used to.

Steps for HMO landlords to take as we enter the new year and Brexit negotiations roll on:

1. **Revise your figures** to ensure you've made adjustments for the reduction in the level at which you can claim tax relief.

2. **Recheck the demand in your area** and speak to your tenants who are not non-UK nationals, to find out what they are planning for the next 12 months.

3. **Talk to local estate agents** to find out whether they've had an increase in enquiries from buyers planning to invest in HMOs, so that you know whether to anticipate an increase in supply.

4. **Given that wage growth may stagnate** and you might not be able to increase rents to cover your increased costs, look at where you could make some cost savings.

5. **Mortgage interest rates have reduced** substantially for landlords over recent years so, if you haven't spoken to your broker in the last 6-12 months, now is the time to check whether you're on the very best rate for your circumstances.

6. **If you haven't increased your rents recently,** look to do so now, while tenants still feel they have a bit of extra money in their pockets.

7. **Consider making a capital injection** and improving the standard of your HMOs. That may take you into the market for tenants who can pay a bit more and/or ensure you continue to offer the better-quality accommodation in your area.