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RESIDENTIAL PROPERTY BY HEARTHSTONE
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Hearthstone Investments: UK housing market remains robust with positive house price growth and rent collection over 98%

UK residential property market

The outlook for UK house prices has significantly improved over the past months. With the rebound in activity since May being remarkably sustained, the market received a further boost with the Stamp Duty holiday announced in July. The impact on the market has been immediate, with house prices rising again since June.

House Prices July 2020

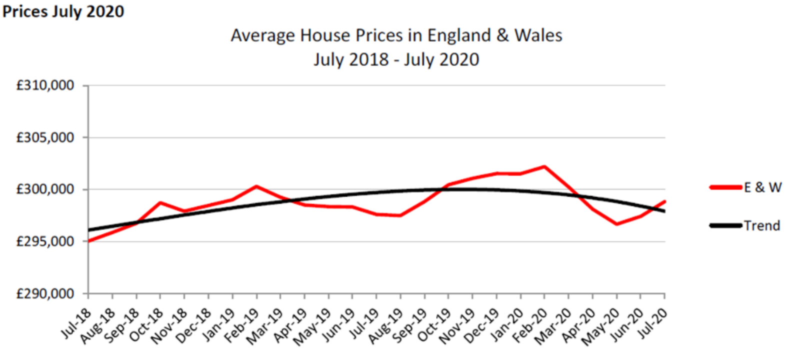


Figure 1. The average house price in England & Wales, July 2018 – July 2020

Source: LSLAcadata

Forecasts for the UK economy

Comparison of independent forecasts, month by month

		March	April	May	June	July	August
2020	GDP	0.6	-5.8	-8.6	-9.2	-9.1	-10.1
	Inflation RPI, Q4	2.2	1.4	1.3	1.2	1.4	1
	Unemployment, Q4	4.2	6.9	7.7	7.9	8	8.3
	House price inflation, Q4	2	0.5	-3.0	-3.8	-3	-2
2021	GDP	1.3	5.0	6.2	6.5	6.6	6.5
	Inflation RPI, Q4	2.9	2.7	2.6	2.5	2.7	2.9
	Unemployment, Q4	4.1	5.5	6.3	6.6	6.5	6.6
	House price inflation, Q4	2.5	2.5	2.8	3.0	3	2

Source: HM Treasury

GDP, RPI and unemployment rate - average of latest forecasts

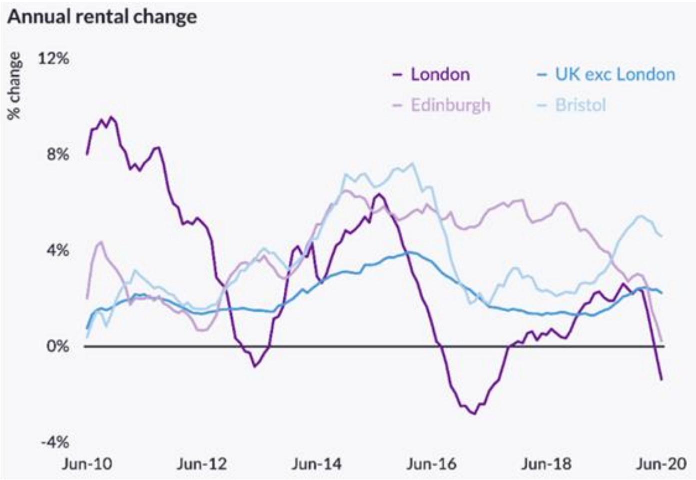
House price inflation - Q4 on Q4 a year ago. Median

Forecasters are gradually more optimistic about 2020 house price growth, having adjusted their forecasts upwards by 1% every month. The consensus forecast remains positive for 2021.

The latest RICS Residential Market Survey paints a similar picture: "As to the future, at the national level, a net balance of +8% of contributors expect prices to increase over the next twelve months. As such, this latest reading is consistent with a flat to marginally positive outlook for house prices in the year ahead." It is worth reiterating that, unlike in the two previous major recessions (1990/91 and 2008/09), house prices did not overheat in the run-up to Covid-19. Over the past years, house price growth was slowing and lenders acted with caution. This reduces the risk of a spike in forced sellers and limits downside to house prices.

The housing market tends to be incredibly resilient in a downturn: people need a house to live in, housing supply is flexible, and the sector is always at the forefront of policy-makers thoughts given its vital importance to overall sentiment. Still, house prices are an emotive topic for some investors, much more so than a holding for instance an ordinary US Equity tracker fund. A home has emotional value and is often leveraged – sometimes provoking fears of negative equity. Rational investors allocating to an ungeared and diversified UK residential property fund are able to look beyond this and assess the facts when analysing the asset class against other more volatile assets.

Rental demand bounced back strongly since lockdown measures have been relaxed. Zoopla reports rental demand running at 33% above pre-lockdown levels, and 25% above 2019 levels. During lockdown, many renters reassessed their options and, once the market reopened, took advantage of the higher speed of securing a rental home compared to a purchase. Annual rents are subsequently expected to rise in most regions.



Source: Zoopla

An interesting picture is emerging in London and, to a degree, in Edinburgh where house prices are expected to outperform relative to other regions. Given higher average house prices, the Stamp Duty holiday has a greater impact in these capitals and a higher proportion of office-based jobs should impact employment less than in other regions. However, there is a less favourable supply/demand balance for rentals due to a combination of office closures and reduced tourism. The latter results in landlords bringing homes with longer tenancies to the market, a trend that is further exacerbated in Edinburgh with recent policy changes. As a result, there is some downward pressure on rents, particularly in Central London.

TM home investor fund

The increasing market activity mentioned above has again been reflected in the Fund's property portfolio which increased in value again in August, following increases in June and July. Month-end valuations for August were up 0.06%, giving a cumulative increase of 0.34% over the last 3 months (due to the Bank Holiday, the August increase was priced into the fund on 1st September). The properties which increased in value this time are at Mansion House in Colchester on average by 1%, due to a recently agreed sale within this scheme, and in Cleobury Mortimer, Shropshire, which increased by c.4%. The Fund's Standing Independent Valuer, CBRE, is continuing to scrutinise the strength of market activity, and has expressed optimism regarding the momentum of house prices in many of the regions in which the Fund is invested.

As mentioned over the past few months, the Fund's performance has highlighted the resilience of the Residential sector versus Commercial - not least, in terms of the strength of rent collection. August has seen this continue, with the Fund collecting 98.5% of rent demanded – broadly in line with our long-term average of 99%. This high rent collection is driven not only by the quality of the Fund's tenants, but also the processes put in place early in the Pandemic in so far that although some tenants did fall into financial difficulties, they have been able to obtain Universal Credit and maintain payment of their rent, demonstrating that residential rental income is very crisis-proof.

The following table contains the latest performance metrics for the Fund:

Key Performance Metric	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20
Total return, C-Class Acc, month	-0.14%	-0.28%	-0.07%	0.07%	0.14%	0.00%
Total return, C-Class Acc , 1 year	1.48%	0.98%	0.70%	0.70%	0.77%	0.70%
Property valuations, as % of property portfolio	-0.22%	-0.38%	-0.14%	0.06%	0.21%	0.06%
Distributed Income, C-Class Inc	n/a	Launched 20/04/2020	2.41% gross *	2.41% gross *	2.41% gross *	2.41% gross *
No of voids (vacant properties), end of month	17	23	21	17	24	17
+ Completed Acquisitions / - Completed Sales	+ 0 / - 3	+ 0 / - 0	+ 0 / - 0	+ 0 / - 0	+2 / -1	+0 / -0
+ Move ins / - Move outs	+ 9 / - 5	+ 0 / - 6	+ 3 / - 1	+ 10 / - 6	+2 / -8	+9 / -2
Rent collected as % of rent invoiced	99%	96%	98%	95%	102%	98%

* estimated annual yield, based on Class C Acc historical yield

Although the month-end snapshot shows 17 vacant units for August, tenancies are already agreed or reserved on 10 of these, so we fully expect this to improve significantly in September, and for occupancy to be back up at pre-Covid levels in the region of 97% very soon.

Stuart Springham

Deputy Fund Manager

7th September 2020