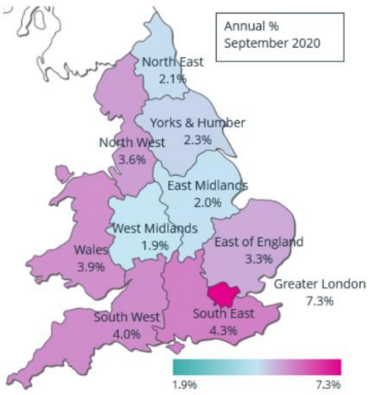
Hearthstone Investments: Strongest monthly performance for TM home investor fund since July 2018

UK residential property market



Source: e.surv (LSL Acadata)

November saw a continuation of a strong housing market even before the positive news on a potential vaccine for Covid-19. The headline house price growth figures continue to be driven by the premium end of the market – both regionally and in terms of types of properties. Wealthier buyers can buy properties despite Covid-19 and benefit most in terms of the current stamp duty holiday. Having said that, the e.surv house price index records positive annual growth across all regions in England and Wales.

Forecasters had a challenging 2020 when it comes to predicting house price growth: Estimates started at +2% in Q1, then dropped as low as -3.8% in Q2 before returning into positive territory. Looking at the wide spread of forecasts for 2021 it is evident short-term forecasting remains highly uncertain: forecasts collated prior to the announcement of a vaccine ranged between -8% to +3%.

Looking at the two main factors resulting in uncertainty that paralysed the housing market over the past couple of years, one can reasonably expect that over the coming six months there will be further clarity on the UK's post-Brexit position and the availability of Covid-19 vaccines. This clarity should allow people to make plans and decisions – including those in relation to their housing needs.

Forecasts for the UK economy

Comparison of independent forecasts, month by month

		March	Avg Q2 2020	Avg Q3 2020	Oct	Nov
2020	GDP	0.6	-7.9	-9.7	-10.2	-11
	Inflation RPI, Q4	2.2	1.3	1.2	1.2	1.2
	Unemployment, Q4	4.2	7.5	8.1	7.3	6.1
	House price inflation, Q4	2	-2.1	-2.3	1.5	1.5
2021	GDP	1.3	5.9	6.7	6.3	4.8
	Inflation RPI, Q4	2.9	2.6	2.8	2.6	2.8
	Unemployment, Q4	4.1	6.1	6.5	7	7.2
	House price inflation, Q4	2.5	2.8	1.6	-3	-3

Source: HM Treasury
GDP, RPI and unemployment rate - average of latest forecasts
House price inflation - Q4 on Q4 a year ago. Median

After three quarters of absorbing the relentless news flow, it might be more useful to take a step back and assess where UK residential property and the UK Private Rented Sector (PRS) stand from a longer-term point of view. The UK PRS is still relatively small compared to those in other markets (for example, Continental Europe and North America) where the residential rental market is dominated by institutional investors. Over the past decade between £1bn and £3bn per annum has been invested in the sector which is now estimated at £40bn.

The Covid-19 pandemic has been a real test for UK PRS, but the sector delivered on its key promises: providing capital protection during times of severe economic stress, and delivering resilient income.

Looking beyond the immediate, Covid-19 is further emphasising the investment case for this asset class. The housing affordability crisis has unfortunately been made more severe by a combination of factors: house price growth, stricter lending criteria for potential house buyers on lower to average incomes, and rising unemployment. As a result, demand for good quality and professionally managed rental property is likely to increase even further from current levels. As of 2019, 20% of people were renting privately in the UK.

The fiscal response to the pandemic has resulted in record levels of public debt, and many worry that a reduction in debt levels can only be achieved by "inflating" debt away in a world where the boundaries between Central Banks and the Treasury seem increasingly blurred. However, should inflation increase, real estate has a well-documented track record as an inflation hedge.

All this points to continuing strong fundamentals for the UK PRS sector. A recent investor survey by Knight Frank estimates that the UK PRS market will grow from £40bn to £75bn by 2025.

TM home investor fund

The strong market activity resulted in increased valuations in the Fund's property portfolio for the sixth consecutive month - valuations for November were up 0.55%, giving a cumulative increase of 1.02% on its properties over the last six months. In total, 41 of the Fund's 204 properties were valued upwards in November and this was spread throughout the country from Bristol to Manchester across 12 sites. Most notably is that these rises were not limited to houses as would be expected, but the Fund's city-centre Manchester flats increased by 5% each. We were also pleased to see that The Limes in Nottingham, one of our more-recent acquisitions and largest holdings, also increasing in valuation.

As outlined above, much of the current headline house price growth figures are driven by the premium end of the market, some of which will be less relevant to the mainstream homes held in the TM home investor fund. The Standing Independent Valuer, CBRE, is keeping a close watch on the fast-changing picture of the UK housing market and the implications on the Fund's portfolio. One specific point to mention is that the RICS Red Book guidelines stipulate that, when valuing a property, transaction prices of comparable properties are only relevant if contracts have exchanged on those sales. Given the sharp rise in transaction volumes, there is significant strain on the various participants in housing transactions leading to some delays; even if there are indications of rising prices from agreed sales, these can't be factored into the Fund's valuations until sales of comparable properties reach exchange of contracts.

The Fund once again demonstrated the resilience of the residential sector with rent collection at 99.5% in November, taking the average monthly collection to 97.9% since the start of the Covid-19 crisis, and in significant contrast to the commercial property funds. We are also seeing occupancy in the portfolio hold steady in the upper 90's%, resulting in the highest monetary rent collection since the start of 2019.

In short, valuations up, high levels of rent collection – a robust continuation of Q4 2020, and the Fund's best standalone monthly performance since July 2018.

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

TM home investor fund

Key Performance Metric	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20
Total return, C-Class Acc, month	-0.14%	-0.28%	-0.07%	0.07%	0.14%	0.00%	0.21%	0.21%	0.55%
Total return, C-Class Acc , 1 year	1.48%	0.98%	0.70%	0.70%	0.77%	0.70%	0.70%	0.77%	1.25%
Property valuations, as % of property portfolio	-0.22%	-0.38%	-0.14%	0.06%	0.21%	0.06%	0.02%	0.12%	0.55%
Distributed Income, C-Class Inc	n/a	Launched 20/04/2020	2.41% gross *	2.41% gross *	2.41% gross *	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	13	13	13
+ Completed Acquisitions / - Completed Sales	+ 0 / - 3	+ 0 / - 0	+ 0 / - 0	+ 0 / - 0	+2 / -1	+0 / -0	+0 / -0	+0 / -0	+0 / -0
+ Move ins / - Move outs	+ 9 / - 5	+ 0 / - 6	+ 3 / - 1	+ 10 / - 6	+2 / -8	+9 / -2	+13 / -9	+9 / -9	+5 / -5
Rent collected as % of rent invoiced	98.7%	96.0%	98.0%	95.0%	102.0%	98.0%	97.0%	98.3%	99.5%

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

Finally, over the past weeks we established a shortlist of developments in the North West, the target for our next acquisition in 2021. Our focus is on 2- and 3-bedroom houses with gardens and we are now entering the more detailed due diligence phase.

Stuart Springham

Fund Manager

4th December 2020

Important information

Past performance is not necessarily a guide to future performance and future returns are not guaranteed. Investors may get back less than the amount invested.

Residential property values are affected by factors such as interest rates, economic growth, fluctuations in property yields and tenant default.

Property investments are relatively illiquid compared to bonds and equities, and can take a significant amount of time to trade.

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