SHOULD WE BE WORRIED ABOUT PROPERTY VALUES DROPPING?

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There has been a lot of talk over the last three months about the COVID-19 outbreak and the knock-on effect it would have, particularly on the property market. In this month's article, I thought I would share my opinion of what to expect over the next 24 months.

It is pretty much a given that we will fall into a recession as a result of the pandemic. The government have tried extremely hard to keep the economy going, but personally I still think we are yet to see the worst. Up to now, the government have been pumping money into the economy, trying to keep many businesses afloat. But what happens when they turn off the tap?

GENERAL PUBLIC

You do not need to be a genius to realise that if the government had not offered to cover the costs for companies to furlough their staff, a lot of businesses would have had no choice but to lay off their employees. This would have spiked the unemployment rate to record highs. Even with the furlough scheme, the unemployment rate has hit 3.9% according to government statistics. Naturally, because many people are now reliant on government aids such as Universal Credit, this will impact the economy in many ways.

For example:

- **Less income and therefore an impact on spending and lower output**
- **Ability to apply for mortgages/ serviceability on existing mortgages**
- **Not having the ability to create savings**
- **Affordability on rent as Universal Credit may now cover the full amount**

Whatever way you look at it, the outlook is grim. Turning this into property, many landlords will have no option but to consider letting their properties to people who claim Universal Credit.

The options are:

- **Leaving the property empty (at a cost)**
- **Letting a property and getting some income – but perhaps not as much as before**

Landlords who own properties in parts of the UK with much higher rents than the benefit rate will suffer as a result. For example, if their rent is £1,000pcm, and Universal Credit only pays £800pcm, it is unlikely that the tenant (who is already feeling the hardship) will be able to make such a shortfall, and therefore there will be a strain on the tenancy.

PROPERTY DEVELOPERS

Property developers will also see the strain as property sales slow. If we refer to the effect of 2008, and property prices drop circa 20% (which is generally the same amount of a developers profit margin in a development), developers may face either not selling their properties because buyers won't be able to get a mortgage. Even if they do find a buyer, the next battle is ensuring the surveyor values the properties at the price required by the developer. If the property is downvalued at circa 20%, developers will face either losing money or breaking even at best.

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Back in 2007 and 2008 I was in this position, and it's a place I never wish to revisit. As soon as the bank had an idea of the crash, they started to trigger a revaluation of the development in the new climate and started to reassess their gearing/loan to value. The majority of development lenders will typically lend circa 60% of the purchase price and 100% of the development cost, based on the valuation of the time.

As property values start to drop, the lenders will be very cautious of the lending levels, especially as many banks faced issues in 2007 and 2008, and they also don't want to be in that position again. I wouldn't be surprised if the bank asked for the development to be revalued, and if the values have dropped, they ask the developer to come up with a contingency plan. In 2008, Lloyds asked me to instantly replenish the development so it was in equity. If I couldn't, they told me they would be looking to recover the development. Back then, I was geared at 80% and as the property prices dropped by 20%, the bank was at 100% gearing.

We had to restructure the loans, which cost thousands in fees, not to mention the months of sleepless nights. I envisage the banks will be on top of this more than ever, not only for developments but also on portfolio landlords.

PORTFOLIO LANDLORDS

Similar to what has been mentioned above, banks like to be assured that they are always within their lending parameters to ensure that they are not over-leveraged. They always think that, in a worst-case scenario, they will make a loss from the resale if the property gets repossessed. They confirm this in their terms and conditions by asking for revaluations in certain economic scenarios. A downward turn in the market could be one of them – and I expect this will be the case as a result of the pandemic.

Whilst writing this article, I have just received an email from my Lloyds relationship manger to ask for a current rent schedule for my portfolio. I sit here today in a very comfortable position – my portfolio is all on capital repayment mortgages at approximately 50% gearing, so there is no fear of the bank asking me to revalue as they are in a very secure position. I set this up back in 2008, to avoid me ever experiencing that stress again. However, their request of a tenancy schedule is an indirect request to confirm that sufficient income is coming in to service the debt level.

I would seriously suggest that all property investors to take stock of their current situation, to see where their portfolio lies in the current climate.

As always, I wish you all the very best within this difficult period.

If you have a question you would like me to answer in next month's article, please email me: **arsh@arshellahi.com** and I'll aim to answer as many as I can over the coming months.

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