

Taking stock

Understanding the effects of recent policy measures on the private rented sector and Buy-to-Let

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THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

EXECUTIVE SUMMARY

1. This report clarifies the role of the private rented sector (PRS) in the UK and the contribution made to it by the Buy-to-Let subsector. It explores recent changes in government policy and how they might affect the PRS, and makes suggestions about the role the sector might be expected to play in the future.

The Private Rented Sector now

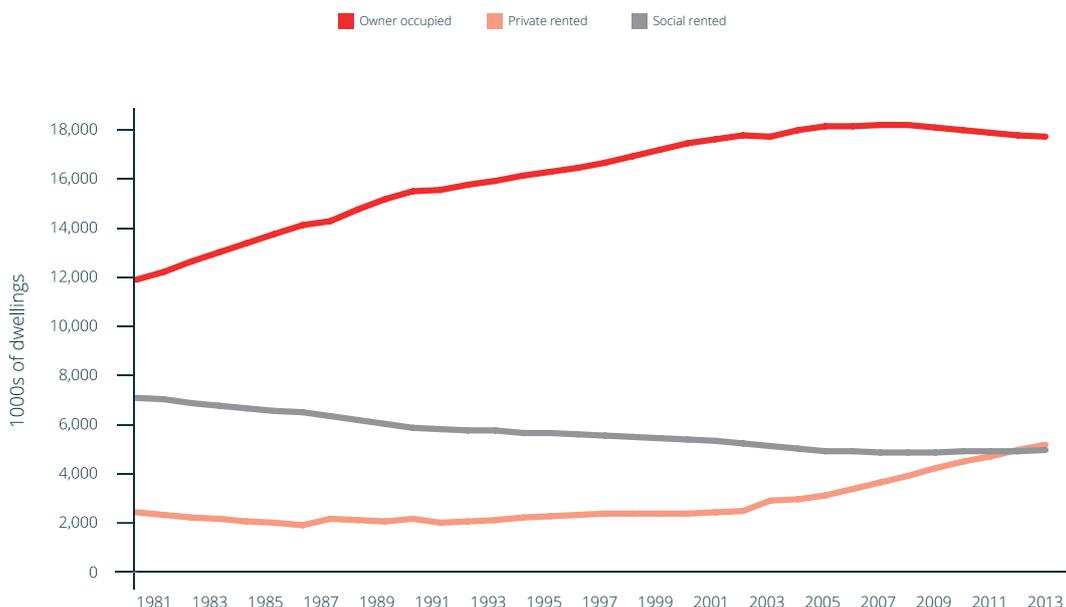
2. The size of the PRS has more than doubled in the last 15 years and now accounts for almost one-fifth of all dwellings in the UK. Despite policy initiatives to encourage institutional investment the bulk of landlords are private individuals, many owning just one unit. Data about landlords and their financial models are patchy and contradictory, although it is clear that those who make a conscious decision to invest (and not all do) often do so as a form of pension provision.



The PRS now accounts for almost one-fifth of all dwellings in the UK

3. The largest numbers and highest proportions of PRS housing are found in central cities and especially in London. Tenants are more likely to be young, working and/or migrants, although increasing numbers of families with children are in the PRS. Large numbers of low income households live in the sector, including students and households who are outside the labour force as well as low paid workers. Over a quarter of PRS tenants are in receipt of the Local Housing Allowance.
4. At the moment landlords are taxed at their marginal tax rate on their rental income net of expenses, which includes interest paid on Buy-to-Let loans as well as wear-and-tear for furnished accommodation. The UK treats landlords for tax purposes rather less favourably than many other developed countries in two ways: it does not allow depreciation nor can rental losses be offset against other types of income. However, there have been significant tax changes recently which may materially impact investment levels in the PRS in the future.

UK housing tenures 1980-2013

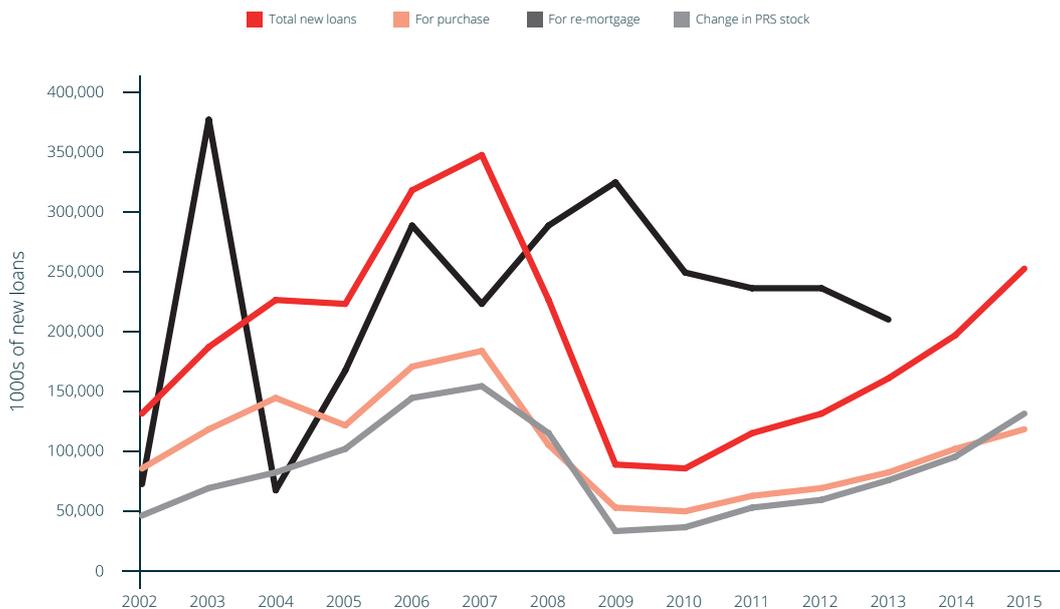


Source: DCLG Live Table 101

Growth and change

5. The PRS had been in decline for nearly a century when it began to grow again very slowly from around 1990. The necessary precondition was the 1988 Housing Act which put in place full deregulation of rents and tenancies. The downturn in the housing market and home ownership around 1990 also had some effect.
6. Significant expansion did not occur until the mid-1990s and can be dated to around the introduction of the Buy-to-Let mortgage in the mid-1990s. Supply grew mainly through the transfer of dwellings from both owner-occupation and social housing (mainly via Right to Buy), rather than through new build. Some, although by no means all these additional PRS dwellings, were funded by the new mortgages. None of the government schemes intended to boost institutional investment had a major impact on the sector as a whole, despite pockets of interest.
7. Especially since the turn of the century, demand has grown rapidly, reflecting the increase in the 'natural market' for PRS (students, migrants, itinerant professionals and younger people more generally). But increased demand has also come from reduced access to owner-occupation (mainly for affordability and deposit reasons); increased economic uncertainty, especially in the labour market; higher debt among potential first-time buyers; the impact of the global financial market; and worsening access to social renting for households who are not in priority need.
8. Given the increases in population and households that are projected in the UK, it is almost certain that the demand for privately rented accommodation will continue to grow over the next decades. To meet this demand there needs to be continued growth in investment in the PRS. Assessing the effects of policy change requires an understanding not just of demand but also of the various types of landlord involved and their different incentives to invest in the sector. The evidence base is thin. It suggests that among private landlords, while Buy-to-Let funding is the most common acquisition model, a significant proportion of landlords buy their properties outright or use other sources of funding, sometimes in addition to Buy-to-Let mortgages.
9. Buy-to-Let lending increased rapidly from its introduction until the financial crisis of 2008/9. In the period immediately before that crisis there were large increases not only in total lending but also in the proportion of Buy-to-Let finance which was in the form of re-mortgaging. This was also the case for mortgages for house purchase. After the crisis mortgage credit of all types was in short supply and other forms of finance - including in particular owners' equity - supported the expansion of the sector. Buy-to-Let funding has now revived (although not as much as that for first-time buyers) and re-mortgaging grew rapidly in 2015, possibly reflecting debt management within growing portfolios.

New UK Buy-to-Let loans for purchase and re-mortgaging and change in stock of PRS dwellings, 2002-2013



Source: CML Table MM17 and DCLG Live Table 101

Addressing the government's concerns

10. Over the last year the government has introduced a number of policy changes specific to the sector. They include an additional property Stamp Duty (SDLT), a reduction in the wear and tear allowance for landlords of furnished tenancies and phased changes in the rate at which tax relief can be claimed on mortgage interest, plus a modification in how tax liability is assessed and when capital gains must be paid.
11. The government has asserted that Buy-to-Let investors compete unfairly with first-time buyers. There has also been a long-term preference among policy makers for a rented sector owned and managed by institutions rather than private individuals as a means of both providing finance and of professionalising the sector.
12. The authorities are concerned about the strong growth of the Buy-to-Let market, which is not regulated by the FCA, although the data on this market are limited. The worry that landlords might sell properties during a crisis does not reflect the experience to date of landlords' behaviour – during the last financial crisis we did not see a mass sell-off of property. The concerns of the Bank of England, who will very likely be granted powers over the Buy-to-Let market, seem overdone.
13. While there is clearly some competition between demand from Buy-to-Let landlords and first-time buyers, the extent of such competition varies enormously across the country as well as between property types. The (very limited) research into direct competition between investors and putative owner-occupiers has found that nationwide only a minority of sales to landlords involved bids from both types of buyer. In many markets there is no meaningful competition and first-time buyers on modest incomes can readily afford homes. In others—mainly in central city areas and inner London in particular—there is strong demand from both landlords and prospective owner-occupiers especially for one and two-bed flats; elsewhere there is little evidence of direct competition between these two forms of housing tenure.

“ *The worry that landlords might sell properties during a crisis does not reflect the experience to date of landlords' behaviour – during the last financial crisis we did not see a mass sell-off of property. The concerns of the Bank of England, who will very likely be granted powers over the Buy-to-Let market, seem overdone.* ”

14. Every year since Buy-to-Let mortgages were introduced more loans have gone to first-time buyers than Buy-to-Let investors in all regions, including London. Landlords can access interest-only mortgages which are more difficult for owner-occupiers to obtain. LTVs for investors are lower than for first-time buyers and the terms for which they are issued are shorter. Moreover, higher LTV loans for first-time buyers are now more common and there is a modest revival in the interest-only loan market, as well as a fairly significant increase in demand for long-term mortgages which, in part seek to create a synthetic interest-only repayment profile.
15. The arguments about landlord behaviour in a downturn have been based on limited survey evidence and apparently without looking back at previous events. The NMG survey used by the Bank of England is a general household survey which appears to include a disproportionate number of younger landlords. In more targeted surveys landlords tend to say they are more likely to buy than to sell, whatever the state of the market. In that sense we judge the likely landlord contribution to financial instability in a downturn to be less than suggested by the Bank and the government. Similarly, although institutional investment will help boost the sector and potentially assist professionalisation and higher standards, it is important not to overstate the contribution it might make relative to the scale of the sector overall.

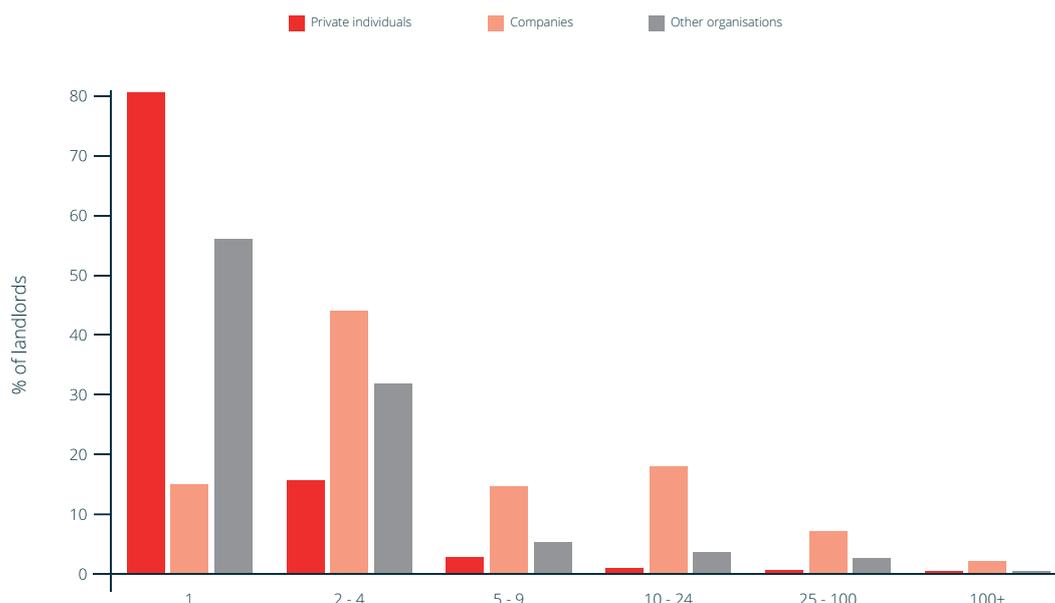
Changing the landscape for Buy-to-Let

16. Increases in SDLT can be expected to reduce landlord purchases and turnover. Mortgage tax changes will reduce returns for many landlords but are not expected to cause them to sell up en masse. Decisions about the role of residential property in overall portfolios will depend on returns on other asset classes, and any rebalancing will take place over a number of years.
17. The future of the PRS will be determined not just by fiscal and regulatory measures but rather by many other factors, including the promotion of home ownership (drawing in some potential tenants) and the relative returns from other investments as well as increasing population and real income growth.
18. The mortgage tax changes announced will mostly impact private individual investors with small portfolios and Buy-to-Let loans. Those who currently pay higher or additional rate tax will clearly be affected. The way that the tax is calculated also means some landlords will be pushed into higher tax rates and/or lose income-related benefits.
19. Together the changes to mortgage tax relief and SDLT (and the reduction in capital gains tax for other types of investment announced in the Budget) will modify the incentive structure for landlords but the scale of the impact on landlord behaviour is unclear. The evidence suggests that, in addition to normal turnover, some will sell a number or even all of their properties; some will reduce gearing; some will postpone or forego further investment in the sector. But others may feel it is a good time to enter the market or expand portfolios as other landlords sell. So the magnitude and timing of these impacts is unknown. Moreover, the effect on supply will depend as much on wider market and economic conditions, including returns available elsewhere, as on specific changes to the taxation of landlords.
20. On the near horizon are further regulatory changes such as increased controls on Buy-to-Let lending and perhaps the stabilisation of rent increases, at least in some cities along with a new capital weightings regime under Basel 3. On 29 March the Prudential Regulation Authority released a consultation paper on underwriting standards for Buy-to-Let mortgages. This was immediately welcomed by the Financial Policy Committee (FPC) which is monitoring developments in this market. The industry still awaits the outcome of the current HM Treasury consultation on powers of determination over buy to-let mortgage lending though it is assumed these will come into being. The FPC will prepare a statement of its policy for the use of powers of direction ahead of any such powers being approved by Parliament.
21. Most immediately there is the four year freeze on the Local Housing Allowance (27% of private tenants claim LHA); the introduction of a cap on what can be paid out which is now biting in inner London; and measures to reduce the supply of social housing at least in the short term.
22. Efforts to encourage institutional investment are bearing fruit and, subject to the finalisation of forthcoming changes in regulations and taxation, will probably not affect large company or corporate landlords. At the moment their incentive to expand is therefore unchanged. However, even if this subsector were to grow as rapidly as optimists suggest, it would still account for only a small proportion of the PRS stock. On the other hand there will be significant incentives to reduce investment among Buy-to-Let landlords. Given the potential increases in demand for privately rented housing from continued in-migration and population growth this will further increase pressures in the market.
23. Government initiatives to facilitate owner-occupation could in principle add up to as many as 100,000 units per annum to the stock in that tenure. Not all will be genuinely 'additional', as some of the households who benefit would have bought anyway, but even so there will be an impact on demand for rented property. The various measures, together with wider economic and demographic trends, can be expected to slow the rate of growth of the PRS but not to reverse the upward trend.

Renting, owning and policy

24. Will private renting continue to grow at a similar pace over the next decades? This depends not only on the effects of fiscal measures and government policy towards the PRS more generally but on developments in other tenures and in wider investment markets.
25. Private individuals are and will continue to be the bulk of landlords, even if institutions massively increase their involvement. The example set by institutions, coupled with larger individual portfolios and tenant demand, will tend to result in increased professionalism more generally.

Portfolio size by type of landlord



Source: Private Landlords Survey 2010

26. While there are reasons to expect owner-occupation to grow at least among mature traditional households it is our view that it is highly unlikely that younger households will enter owner-occupation to the extent that they did in earlier decades. Such a scenario implies that the proportion of owner-occupation in England could grow to between 64% and 66% of the total stock over the next few years and stabilise at around that level.
27. Equally, social housing might under some, perhaps unlikely, circumstances remain at roughly its current size as housing associations respond to the challenge to expand without direct subsidy. However, it is far more probable that it will decline, especially if partial ownership starts to take a larger role in affordable housing provision. An estimate might be that it would fall over the next few years to under 15% of the total stock. Indeed, over time, unless there is a policy reversal, for example, as a result of a change in government, it could decline further, to as little as 10%.
28. Taken together, these scenarios would suggest a PRS in the range of 20% and 22% within this parliament and perhaps 25% as the longer term equilibrium level. These are significant increases especially in absolute terms, even though they are lower than many other projections. They reflect current government policy and an assumption that the economy continues to improve. If the outlook is more negative, the proportion in private renting will be higher. But if real household incomes rise more rapidly the proportion in owner occupation could be higher, more in line with mature Northern European markets that still favour that sector. If so, many younger households will continue to rent, but the vast majority of stable working households will be owner-occupiers.

Conclusions

29. In summary, private renting plays and will play a key role in the UK's housing system. It keeps pressure off the home ownership sector by offering households a clear alternative whether for the short or long term. It also plays a role as an alternative to the provision of social housing.
30. The continuing flow of regulatory and taxation changes being introduced and considered will slow the expansion of the PRS at a time when there are limited alternatives. However, on current trends demand for private renting is almost certainly going to continue to rise in both absolute and proportional terms. The key concern is whether there will be sufficient landlords to continue to meet the continuing growth in tenant demand. Any slowdown in the expansion in supply of privately rented housing arising from changes in taxation and regulation will put pressure on rents and household budgets.
31. Even if institutional investors enthusiastically enter the market, individual landlords will remain dominant – as they are across Europe. Shrinking the sector therefore does not seem a sensible way forward given what we know about unmet demand and need.
32. In an ideal world we could identify the goals of policy changes, establish a baseline and monitor outcomes to see if these goals were met. In this case however, the government's goals are multiple and sometimes inconsistent and poor data make high quality monitoring difficult if not impossible. If we are to understand and manage the sector better, we need to improve the data as quickly as possible.

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INTRODUCTION

This report clarifies the role of the private rented sector (PRS) in the UK and the contribution to it through the Buy-to-Let subsector. It explores recent changes in government policy and how they will affect the PRS, and makes suggestions about how the sector can play an effective role in the UK housing system. This chapter clarifies the objectives of the research, the reasons for addressing these issues and the position of the Buy-to-Let market within the overall total rented sector.

In January 2016, Paragon Group commissioned the authors to write an independent review of policy developments in the private rented sector (PRS) in general and the Buy-to-Let market in particular. The objectives of this study, undertaken from mid-January to the end-February, were:

- first, to clarify the role played by the PRS in the UK (notably England) and how that role has evolved since the PRS started to grow in the 1990s;
- second, to identify to the extent possible the Buy-to-Let segment within the broader private rental market;
- third, to understand the direct and indirect impacts of government policy initiatives on the health of the Buy-to-Let market and the sustainability of the PRS as a whole;
- fourth, to suggest what the implications of these policies are for the future of Buy-to-Let and private renting more generally; and
- finally, to draw conclusions about what is necessary for the PRS to play an effective role in housing provision.

The background

The immediate reasons for undertaking this study are the changes in taxation and regulation that the government has announced over the last year and the changing attitudes to private renting, particularly with respect to Buy-to-Let among policy makers and those responsible for macro-stabilisation and regulation.

A more fundamental reason lies with the rapid growth of the PRS across the UK which has more than doubled since the turn of the century supported by the expansion of the Buy-to-Let market. Much of our understanding of how the sector operates is based on data and analysis which refers back to earlier in the century and even further and the sector has not been fully tested in the new post Global Financial Crisis environment. This research aims to bring together the best available data to clarify both the current position of private renting; its role in the overall housing market; and where it might be heading.

Defining private renting and Buy-to-Let

It is important to be clear about definitions and to clarify the terminology used in this report. Most people believe they understand what the PRS is, but for statistical purposes it is often simply defined as all housing that is not owner-occupied or social rented. The term can cover on the one hand very short-term lets and rooms let to lodgers, and on the other, properties in which the same households have lived for decades under controlled conditions. Some would define the PRS as dwellings let at market rents, but the sector includes many properties where rents are nowhere near market levels--indeed some PRS housing is rent-free (properties provided by parents for their children, for example). Moreover, while the vast majority of landlords are individuals, corporate entities, local councils and housing associations may also own private rented property. That said, the majority of PRS landlords and tenants are willing buyers and sellers who contract on the basis of Assured Shorthold Tenancy arrangements with a minimum security of six months.

The idea of Buy-to-Let may simply be about motivation among individuals and small companies. But in practice the term can be defined in a number of different ways. Buy-to-Let is often used to refer to all properties purchased to let out on the market by individual landlords, whether using equity or debt. This definition includes owner-occupiers who (re)mortgage their principal homes to buy a rental property, as well as those who have paid off their mortgage (whatever form it took). But in the financial context, and in the context of the issues government is currently concerned about, Buy-to-Let refers to a particular form of mortgage introduced in the mid-1990s and based on rental returns, which may be taken up by individuals or companies. In the main policy sections of this report, 'Buy-to-Let' refers to that part of the market currently financed by such mortgages and to those buying and selling properties within this subsector. Originally a brand name, the term is now used generically.

THE PRIVATE RENTED SECTOR TODAY

This chapter profiles the private rented sector (PRS) in the UK. Its size has more than doubled in the last 25 years and the sector now accounts for about one-fifth of all dwellings. Despite policy initiatives to encourage corporate investment the bulk of landlords are private individuals, many owning just one unit. Data about landlords and their financial models are patchy and contradictory, though it is clear that those who deliberately invested (and not all did) often did so as a form of pension provision.

The highest proportions of PRS housing are found in cities, especially London. Tenants are more likely to be young, working and/or migrants, though increasing numbers of families with children are in the PRS. The decline in the number of social rented units means many low-income households live in the sector, and about a quarter of PRS tenants receive housing benefit.

Landlords are taxed at their marginal rate on their rental income net of expenses, which at the moment includes interest paid on Buy-to-let Loans. The UK treats landlords for tax purposes rather less favourably than many developed countries in two ways: it does not allow depreciation nor can rental losses be offset against other types of income.

What is private renting?

The private rented sector (PRS) is defined in UK statistics as all rented dwellings not owned by local authorities or housing associations. Thus it comprises dwellings owned by private individuals or companies and rented, generally at market rents, to other households. According to the latest figures, the PRS makes up 19.6% of dwellings in England (DCLG Live Table 104). The PRS houses 19% of households (DCLG: English Housing Survey 2014/15). This makes England broadly typical of European nations (Table 2.1) although there is a wide spread of tenure patterns: Germany and Switzerland have much larger private rented sectors, while in Spain and the Netherlands the sectors are much smaller².

Table 2.1: Private rented sector as proportion of dwelling stock in European countries

| Country | % of stock | Year |
|-------------|------------|------|
| Germany | 49 | 2010 |
| France | 21 | 2011 |
| Ireland | 19 | 2011 |
| England | 18 | 2011 |
| Denmark | 17 | 2011 |
| Austria | 16 | 2012 |
| Scotland | 12 | 2011 |
| Spain | 11 | 2011 |
| Netherlands | 9 | 2010 |

Who is housed in the PRS?

On the whole, households in the PRS are more likely to be

- Young – 35% are aged 25 to 34
- Singles or couples (although the proportion of families with children is growing)
- On lower-than-average incomes
- Migrants from other countries.

Table 2.2 summarises some of the more important attributes of the sector. In particular, it shows that private renting is for those of working age and mainly for those who are in work. It plays a key role in accommodating households coming into the country from abroad and those moving around the country, particularly for job-related purposes. The vast majority of international migrants entering the country move into privately rented accommodation: 74% of those who have been in the country for less than five years live in the PRS. This only drops to below 50% among those who have been here for more than ten years. Overall, 39% of foreign born households are private tenants (Vargas-Silva, 2015).

The PRS also plays an important role in accommodating those, including homeless families, who are unable to access social housing. Such households are normally outside the labour force and depend on housing benefit to pay their rent (Wilcox et al, 2015).

Table 2.2: Characteristics of private tenants in England, 2014/15

| | Private tenants % | Social tenants % | Owner occupiers % |
|---|----------------------|---------------------|----------------------|
| Gross weekly household income under £300* | 30 | 58 | 18 |
| Economic status of head of household | | | |
| full or part-time work | 71 | 38 | 61 |
| other inactive | 9 | 22 | 3 |
| retired | 9 | 30 | 35 |
| full-time education | 5 | 9 | 1 |
| unemployed | 7 | 1 | 0 |
| Household type | | | |
| couple, no dependent child(ren) | 23 | 16 | 44 |
| couple with dependent child(ren) | 23 | 16 | 23 |
| one person under 60 | 20 | 17 | 9 |
| other multi-person households | 14 | 11 | 6 |
| lone parent with dependent child(ren) | 13 | 17 | 2 |
| one person aged 60 or over | 7 | 24 | 16 |
| Ethnicity: Head of household not British or Irish* | 23 | 7 | 3 |

Source: English Housing Survey 2013/14; English Housing Survey Headline Report 2014/15. *latest available data 2013/14.

¹Where relevant in this discussion we exclude resident landlords, as research has found that they differ significantly in terms of motivation and business model from other landlords (Crook and Kemp, 2011).

²However it should be noted that the definition of the PRS varies considerably between countries and it is often a residual figure.

With respect to the role of private renting in mobility more generally, the English Housing Survey shows that around one-third of private tenants have moved in the past year as against 11% of all households, while two-thirds of private tenants have been in their current accommodation for fewer than three years. In 2014-15, 57% of private tenants said they expected to buy—a fall from 61% the year before. However, over the longer term the rate was not significantly different from the 59% of private renters who expected to buy in 2008-09 (DCLG, 2016).

What do they pay?

Like so much of the information about the PRS, the data about private rents are incomplete. One official source gives an average (mean) private rent in England in 2014/15 of £775 (English Housing Survey, 2014/15). Another says £625 was the median private rent for the same year (Valuation Office Agency), suggesting that the average figures in the English Housing Survey are pulled up by some very high rents.

The English Housing Survey gives distribution of rents by household type. In 2013/14 (the most recent year for which this breakdown was available) the average PRS monthly rent for all household types in England was £763 (Table 2.3). Multi-person households (generally single people sharing) paid the most, at an average of £1135, while single persons paid on average about half that (£563).

Table 2.3: Average monthly rents by household type, all England

| | 2013 / 14 | 2014 / 15 |
|---------------------------------------|-----------|-----------|
| | £ | £ |
| Household type | | |
| other multi-person households | 1135 | |
| couple with dependent child(ren) | 797 | |
| couple, no dependent child(ren) | 719 | |
| lone parent with dependent child(ren) | 715 | |
| one person | 563 | |
| All private renters | 763 | 775 |

Source: English Housing Survey 2013/14 Annex Table 4.3; 2014/15 Annex Table

There is large regional variation in rents. The highest levels are found in inner London, and the lowest in the north of England. Table 2.4 presents data for England from the Valuation Office Agency, and for England and Wales from an estate-agency survey based on 20,000 properties.

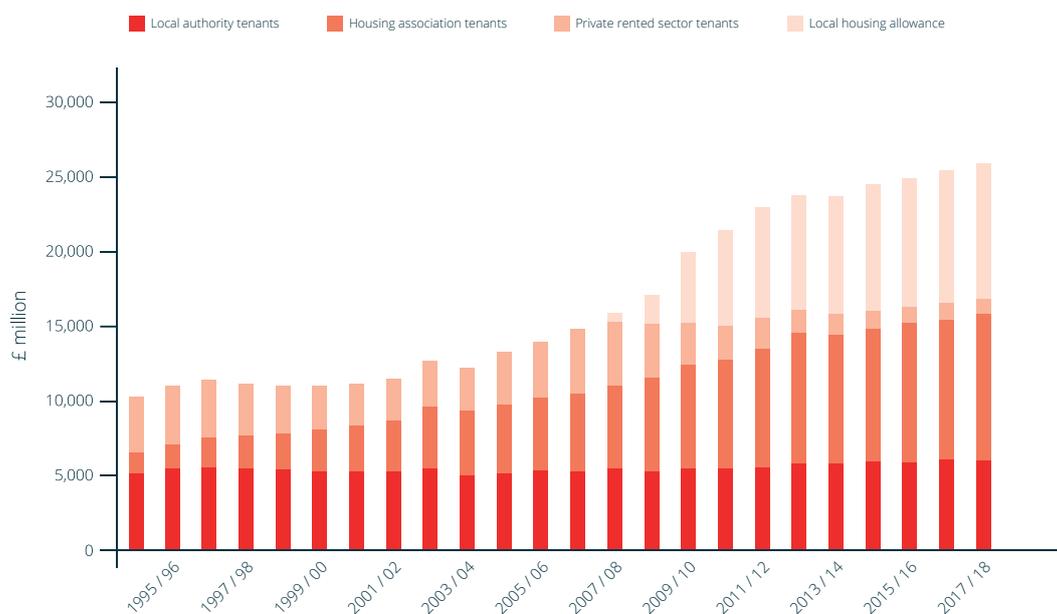
Table 2.4: Median and lower-quartile monthly rents by English region

| Area | VOA Oct 2014 - Sept 2015 | | Your Move/Reed Rains December 2015 |
|--------------------------|-----------------------------|--------|---------------------------------------|
| | Lower Quartile | Median | Average |
| | £ | £ | £ |
| ENGLAND | | 625 | |
| ENGLAND AND WALES | 1135 | | 794 |
| London | 1,100 | 1,400 | 1,251 |
| Inner London | 1,300 | 1,625 | - |
| Outer London | 995 | 1,250 | - |
| South East | 650 | 800 | 766 |
| East | 550 | 656 | 831 |
| South West | 545 | 650 | 669 |
| West Midlands | 450 | 550 | 593 |
| North West | 425 | 525 | 599 |
| East Midlands | 430 | 525 | 608 |
| Yorkshire and the Humber | 425 | 498 | 556 |
| North East | 400 | 475 | 517 |
| Wales | - | - | 560 |

Source: Valuation Office Agency Private Rental Market Summary Statistics 2014-15; Your Move/Reeds Rains Buy-to-Let Index December 2015

Some 27% of private tenants receive housing benefit and a further 10 - 15% are thought to be eligible for small amounts of allowance but do not claim. Figure 2.1 shows how housing benefit and allowance for the PRS have grown since the 1990s, with projections to 2018 (as at 2013). Since then projected figures have been held roughly constant by additional policy constraints on payments and by the rise in the number of working households. However, over the next five years, benefits paid to PRS tenants are expected to continue to rise as a proportion of the total, accounting for a projected 39% of the total housing benefit bill of over £24bn in 2020/21 (UK Government, 2015). This is higher than payments to the housing association sector.

Figure 2.1: Housing benefit expenditure by tenure, Great Britain, 1994/95–2018/19



Source: Outturn and Forecast, Autumn Statement 2013, Housing Benefit <https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2013>

The stock of homes in the PRS

Private rented housing is concentrated in cities (especially London). In the UK most rental housing, like most housing generally, is in the form of houses, even in areas with a high proportion of renting. However, flats are over-represented in the PRS stock and the 'typical' PRS unit is considered to be a two-bedroom flat. According to the 2013/14 English Housing Survey, 21% of England's dwelling stock was flats but they accounted for 35% of private rented housing. In London, where overall 49% of dwellings are flats, they account for 57% of private rented housing (Table 2.5).

Table 2.5: Private rented stock by type of area and dwelling, 2013/14

| Area | Houses | Flats | Other types of dwelling |
|-------------------------------------|-----------|-----------|-------------------------|
| | % | % | % |
| London | 37 | 57 | 6 |
| Urban other | 65 | 33 | 2 |
| Rural | 88 | 12 | 0.3 |
| All private rented dwellings | 62 | 35 | 3 |

Source: English Housing Survey, 2013-14, Annex Table 4.8

According to the Private Landlords Survey about three-fifths of the dwellings owned by private individual landlords are houses (59%) and just over a quarter are purpose-built flats (Table 2.6). Company landlords own a higher proportion of flats but even so, over half their dwellings are houses. (It should be noted however that the sample sizes for companies and other organisations were small—136 and 131 respondents respectively.)

Table 2.6: Types of private rented dwelling owned by landlord type (dwelling weighted)

| Dwelling type | Types of landlord | | |
|---------------------|---------------------|------------|---------------------|
| | Private individuals | Companies | Other organisations |
| | % | % | % |
| Terraced house | 35 | 23 | 19 |
| Semi-detached house | 14 | 17 | 25 |
| Detached house | 10 | 11 | 28 |
| Purpose-built flat | 27 | 32 | 18 |
| Converted flat | 14 | 17 | 10 |
| Total | 100 | 100 | 100 |

Source: Private Landlords Survey 2010, Annex Table 3.2

Newer units, especially in London, are often in high-rise blocks, but these are outnumbered by conversions of Victorian houses. Overall 32% of the PRS in England was built before 1919 as compared to 20% of the total stock. Even so the proportion of PRS units which were built in 1990 or later is higher than average; these recently built homes account for 18% of PRS units as compared to 15% of the overall stock. Importantly nearly 50% of housing in English central city areas is privately rented, as is 31% of the stock in these central areas together with other urban centres. Thus private renting is far more concentrated than other tenures in areas that are easily accessible to work and leisure activities. In these areas private renting makes up a significant proportion, sometimes the majority, of transactions in newly built stock (Scanlon and Walmsley, 2016).

In the UK, dwellings are generally owned by individuals and small companies with a small number of units, so that even in a high-rise block that is mostly rented there will be many different landlords. This presents a clear contrast to other countries (e.g., USA and Denmark) where the typical transaction unit is the entire building.

Who are the landlords?

In general there is no requirement for permission to become a landlord, or (in most of England) to register a dwelling as rented. This means that our understanding about the characteristics of landlords, or even how many there are, is relatively poor. Extrapolating from the 2010 private landlords survey (see below) and other evidence suggests that the most likely figure is between 1.5 and 2 million – see Annex 1.

There are a number of sources of data that do provide indications of landlords' characteristics, attitudes and business models, but the data are far from comprehensive. The widely cited Private Landlords Survey commissioned by DCLG every few years is in principle a representative survey, but covers England only, and last time (2010) the sample size was less than 600. Most of the other surveys (which often employ simple online survey techniques) are conducted by associations of landlords or agents or by lenders, so there are clear issues of sample bias. Table 2.7 describes the major recent surveys of English or UK landlords.

Table 2.7: Characteristics of surveys of landlords

| Name | Date of most recent | Frequency | Method | Coverage | Carried out by | Number of respondents | Comments | Regional breakdown |
|---|------------------------------|---|---|------------|---|---|--|--------------------|
| Council of Mortgage Lenders Buy-to-Let survey | 2004 | One-off | Paper survey distributed to customers of 12 buy-to-let lenders | UK | Industry body | 1340 | Covered only those landlords with a mortgage | • |
| DCLG Private Landlords Survey | 2010 | Periodically (about every 4 or 5 years) | Face-to-face and telephone interviews with landlords and agents of tenants from EHS | England | Commissioned by government department | 1051 overall o/w 599 landlords (remainder agents) | Designed to be representative and statistically valid, but small sample size | |
| BDRC Continental / NLA | December 2015 – January 2016 | Quarterly | Online survey of NLA members + telephone interviews of client customers | UK | Market research firm | 1364 | Contains useful detail on business models and portfolios | • |
| ARLA Survey of Residential Landlords | Autumn 2014 | Quarterly from 2004 but now ceased | Online survey of visitors to ARLA website | UK | Trade association | 1016 | Can be used to track market sentiment 2004-2014 | • |
| HomeLet | October 2015 | Not stated | Not stated | UK | Online estate agency | 1882 | Focuses on landlords' relationship with tenants | |
| Property Academy Landlord and Tenants | 2015 | Annual | Online survey of visitors to Property Academy website | Not stated | Training and event organisers for property industry | 2313 | Focuses on landlord/agent relationship | |
| Your Move/ Reed Rains | September 2015 | Quarterly | Not stated | | Estate agency group | 1192 | | |
| Mintel Buy-to-Let Mortgages 2015* | Annual | n/a | n/a | | Market research firm | | Cost £1750 | |

*Not publicly available--for purchase

As Table 2.7 suggests, most surveys of landlords are not statistically robust. The only authoritative, statistically rigorous and representative survey of landlords is the DCLG Private Landlords Survey already referred to. This has useful information about who landlords are in terms of whether they are individuals or companies and the characteristics of their portfolios. However, it was last carried out in 2010 so is now out of date (the sector in England has grown by 17% between 2010 and 2014). The sample size was small (only 599 landlords, as opposed to agents) and it covers England only, so it cannot be used for analysis at a UK level or for regional breakdowns. Finally, it covers a huge range of topics of interest to the government (e.g. willingness to let to tenants on Housing Benefit; use of Energy Performance Certificates) but contains relatively little about landlords' financial models—there were only two questions about mortgages, and Buy-to-Let mortgages are not specifically identified.

The other surveys mostly rely on self-selection by landlords who visit a particular website or use the services of an agency or association, and their samples are therefore almost certainly biased. The BDRC surveys members of the National Landlords Association through its so-called 'Landlord Panel', although it is not clear from the published methodology whether this is a genuine panel (i.e. the same individuals questioned every time).

The best source of detailed information about landlords' financial models and specifically their use of buy-to-let mortgages remains the 2004 CML study (Scanlon and Whitehead, 2005). This covers England, Wales and Scotland. However, it is now very much out of date. It focuses on the motivations, business models and financial arrangements of buy-to-let landlords. We look at the most relevant findings below. But this research also had shortcomings: for instance, the wording of the questionnaire did not allow us accurately to determine what proportion of each landlord's portfolio was backed by a mortgage.

Table 2.8: Findings from surveys of landlords

| Name/ Date | % owning a single property | Business model | | Average portfolio (number of units) | Funding method for next property purchase | % of properties backed by a mortgage | Reaction to mortgage tax changes |
|---|----------------------------|-------------------|--------------------------------------|-------------------------------------|--|--|--|
| | | Main business (%) | Investment but not main business (%) | | | | |
| CML / 2004 | 27 | 11 | 89 | 4 | | At least 25% owned some properties outright and others backed by a mortgage. | |
| DCLG Private Landlords Survey / 2010 | 78 | | | | | 56% of property purchased backed by mortgage | |
| ARLA Survey of Residential Landlords / 4Q2014 | 18 | | | | | | |
| BDRC Continental/ NLA / late 2015 | 14 | 26 | 57 | 8.2 | BTL mortgage 60% Buy outright 29% Release equity 24% | BTL 44% Owned outright 30% Part BTL/part outright 26% | 5% of respondents will reduce portfolio; 28% not increase. Those with biggest portfolios most likely to sell |
| HomeLet / Oct 2015 | 55 | | | | | 56.5% have mortgaged property; 43.5% unmortgaged | |
| Property Academy / 2015 | 58 | 7 | 52 | | | | |
| Your Move/ Reed Rains / Sept 2015 | | | | | | | 4.5% of respondents said decrease in mortgage tax relief would be a reason to sell |

Sources: per table

Type of owner

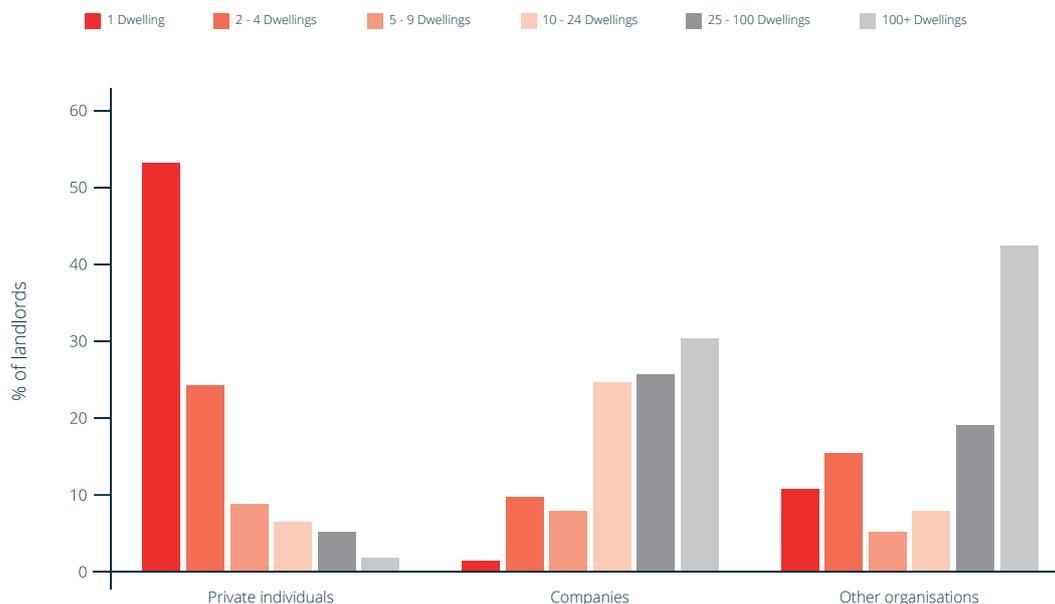
Most private landlords in England are private individuals or couples. The DCLG Private Landlords Survey is one of the few sources that covers the entire sector rather than focusing on private individuals. It showed that 89% of landlords were private individuals, 5% companies and 6% other organisations (Private Landlords Survey, 2010).

The Wealth and Assets Survey (WAS) provides details of household assets, including private rental property, in Great Britain. The survey is run in two-year waves; the most recent (Wave 4) covered the period 2012-2014, and preliminary results were released in December 2015 (ONS, 2015). However, this general publication contains little information about landlords, saying only that 4% of the 20,000 households surveyed owned a Buy-to-Let property.

There is some useful information in a 2013 report based on the second wave (2008-2010), although inevitably it is now somewhat out of date (Lord et al, 2013). There were 1274 private landlords amongst the Wave 2 respondents. This report found that 72% of them owned a single property. Households with PRS landlords had greater financial wealth than the general population even excluding the value of their rented properties, tended to live in larger-than-average homes, and were more positive about their overall financial situations. Three in five thought investing in property was the safest way to make money, and about half thought it was the best way to save for retirement. Most landlords (about 60%) said they earned more money from their jobs than from rental income. The WAS questionnaire asks only about mortgages on the household's principal residence, so the survey provides no information about respondents' use of Buy-to-Let mortgages.

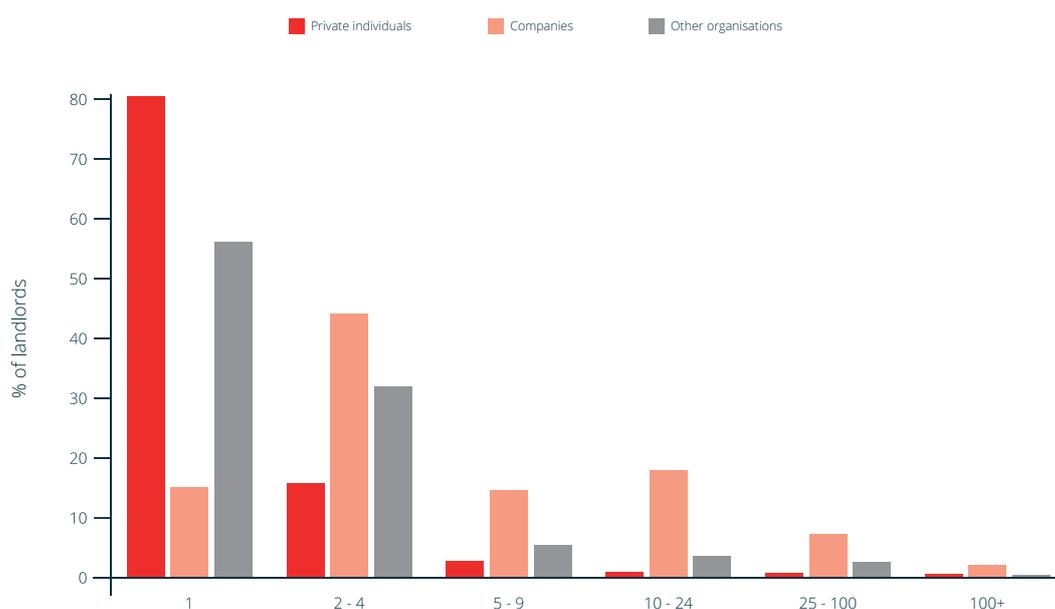
Company and organisational landlords tend to have larger portfolios (Figure 2.2), and together own 29% of the stock. Still, the vast majority of the stock, 71%, is owned by private individual landlords. The Private Landlords Survey found that the great majority of private individual landlords owned only a single property, and 97% owned fewer than five dwellings (Figure 2.3). Other surveys showed lower proportions of landlords owning a single dwelling (Table 2.8), ranging from 18% to 58%, which may reflect the growth of the sector over the last few years. This range of figures demonstrates the unreliable and patchy nature of the data about private landlords.

Figure 2.2: Type of landlord by portfolio size



Source: Private Landlords Survey 2010

Figure 2.3: Types of landlord by portfolio size



Source: Private Landlords Survey 2010

It is difficult to determine how many large corporate landlords are in the sector, because the statistics are broken down only by private individuals and companies, and it is relatively common for even small landlords to own properties through a company. The breakdown of types of landlord by portfolio size (Figure 2.2) shows that companies and other organisations are much more likely than private individuals to have portfolios of more than 100 units. However, it is clear that there are fewer large corporate landlords in England than in some countries (USA, Germany). Grainger is the largest PRS specialist firm in the UK, managing about 3600 units.

In London in particular there are many foreign, non-resident landlords. The new-build blocks along the Thames in London and in locations like Greenwich and Croydon have proved attractive to overseas buyers, particularly from the Far East³. They typically buy one or more units within the block off-plan then rent them out on completion, using local agents to manage them.

For many years government policy has been to attract institutional investors to the sector, the argument being that they would provide more efficient and professional management and better-quality accommodation than either smaller landlords or professional agents. A small number of institutions have entered the market, mainly in London. These include investors from other countries such as Germany and the USA (e.g. the Washington State Pension Fund) more familiar with purpose-built rental developments (known in the UK as 'build to rent'). Increasingly, domestic institutions are entering the market (Addleshaw Goddard and BPF, 2016); M and G for example is working in partnership with builders Crest Nicholson, providing upfront financing in return for build-to-rent product. Some analysts say that 'a wall of money' is waiting to invest in purpose-built private rented housing once risk and viability issues can be sorted. However, it is accepted that most will only wish to purchase whole completed buildings and there is a shortage of such investments available especially given pre-sales.

³The preponderance of foreign buyers in these developments has generated political controversy, and some developers now market products first in the UK. However the length of time between agreeing an off-plan purchase and receiving keys to the dwelling can be problematic for UK buyers who require a mortgage, as mortgage offers for owner occupiers last a maximum of six months before they require reconsideration. Overseas cash buyers do not have this problem nor do UK cash buyers!

Age of individual private landlords

Landlords tend to be middle-aged and older, although the sources give different figures as to the distribution; ARLA survey found very few under the age of 35, while the Wealth and Assets Survey showed 16% of landlords to be in the younger cohorts (Table 2.9). The NMG Consulting household survey for the Bank of England (see Chapter 4) contained responses for 342 landlords. Their age profile was strikingly different, with 37% of landlords aged under 35. This seems implausible as a representative sample of the sector, a point we return to in that chapter.

Table 2.9: Percentages of individual landlord by age category

| | ARLA 4Q2014 (964 responses) | Wealth and Assets Survey Wave 2 2008-10 (1274 landlord responses) | NMG household survey for Bank of England September 2015 (342 landlord responses) |
|----------|--|--|---|
| Under 26 | 0.4 | 1 | (18-24 years old) 18 |
| 26 to 35 | 2.4 | 15 | (25-34) 19 |
| 36 to 45 | 11.7 | 24 | (35-44) 18 |
| 46 to 55 | 27.9 | 27 | (45-54) 13 |
| 56 to 65 | 34.8 | 22 | (55-64) 14 |
| Over 65 | 22.8 | 12 | (65 or over) 18 |

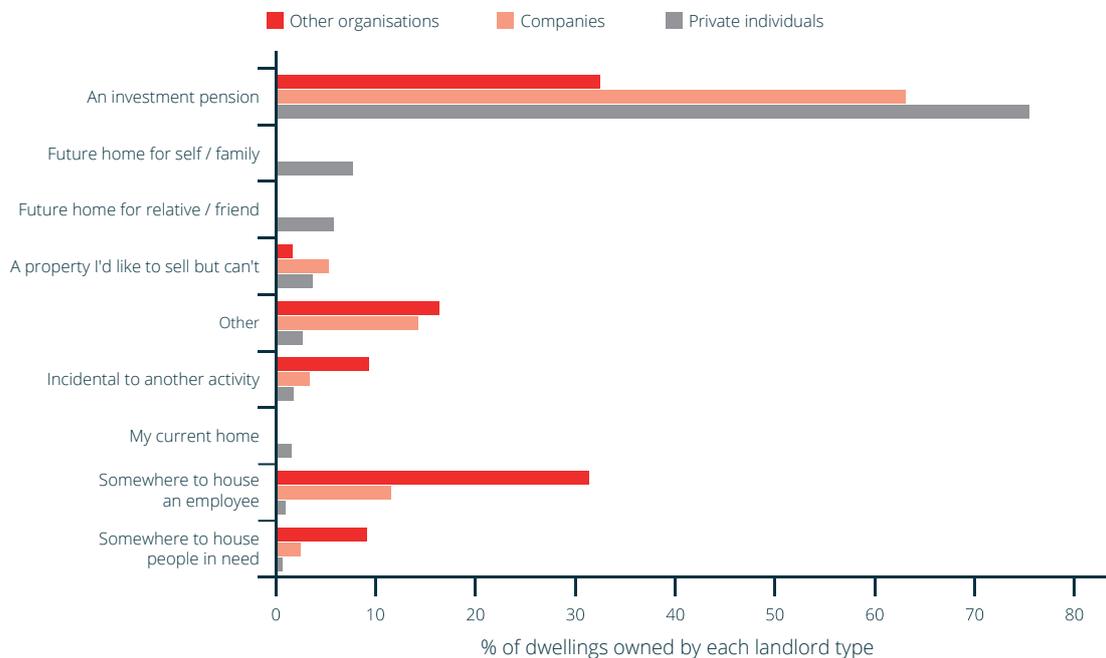
Source: Carey Jones 2014; Lord et al 2013; NMG 2015

Landlord business models

The degree of ‘professionalism’ amongst small private landlords is a topic of some interest given that one of the government’s long-standing goals is to increase professionalism in the sector. The forthcoming changes to Stamp Duty Land Tax (see Chapter 4) were originally expected not to apply to company landlords with portfolios of at least 15 units, implicitly suggesting a definition of professionalism (although in the event it was decided that all landlords, even those with large portfolios, would pay the additional tax). But although several of the surveys address this question they all use slightly different concepts: some ask whether landlords themselves consider themselves to be professionals; some ask whether being a landlord is a part-time or full-time job; some ask how much residential rent contributes to landlords’ household income; and some ask what the landlord’s motivation for being in the sector is. The ARLA survey found that 70% of respondents considered themselves ‘professional’ landlords (Carey Jones, 2014). Scanlon and Whitehead defined professionals as those who received rental income equal to at least the national average income and could live off their income without selling properties to realise capital gains. Applying this method to the CML survey data they defined 20.5% of respondents as professionals (Scanlon and Whitehead, 2005).

As noted, landlords have many different reasons for being in the sector. Although investment reasons dominate by no means all of these reasons relate to financial gain (Figure 2.4).

Figure 2.4: Purpose of owning rented dwellings by landlord type

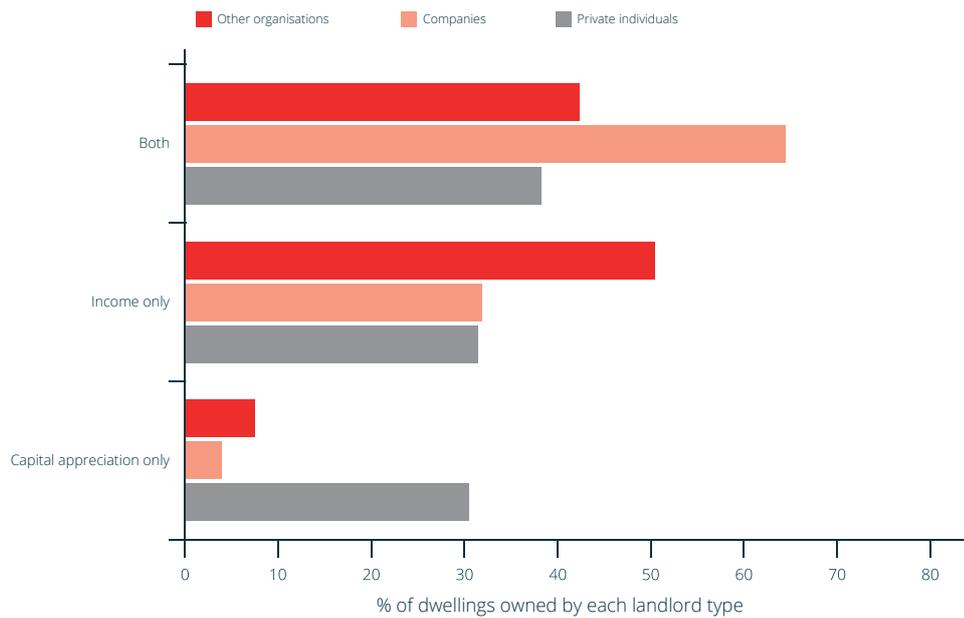


Source: Private Landlords Survey 2010

Some 21% of the dwellings owned by individual landlords are properties where the landlord themselves used to live, and the landlord still lives in 2% of individual-owned PRS dwellings (Private Landlords Survey 2010). Although government policy seems to be predicated on the idea that corporate landlords are more business-like than individuals, companies and other organisations often did not consider their PRS holdings to be a business and had other motivations for being in the sector, in particular to house employees (Figure 2.4). Small private landlords are most likely to view their dwellings as investments or contributions to pension provision.

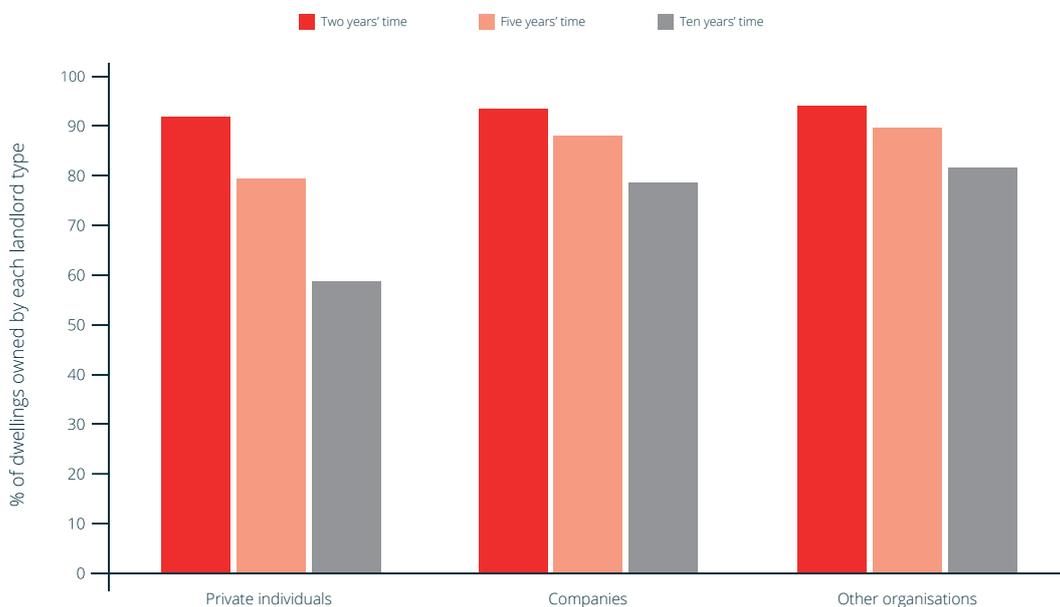
'Other organisation' landlords were more likely to be interested in taking an income out of their properties, while companies and private individuals were looking for a combination of income and capital growth. Those interested only in capital growth were much more likely to be private individuals than other types of landlord (Figure 2.5). The ARLA survey suggested that almost all respondents had financial motivations for being a landlord. Some 45% were seeking combined rental income and capital appreciation from their residential investments, 32% were seeking long-term capital gains and 13% were looking mainly for a rental yield.

Figure 2.5: Type of return sought by landlord type



Source: Private Landlords Survey 2010

Figure 2.6: Will be in the sector in...



Source: Private Landlords Survey 2010

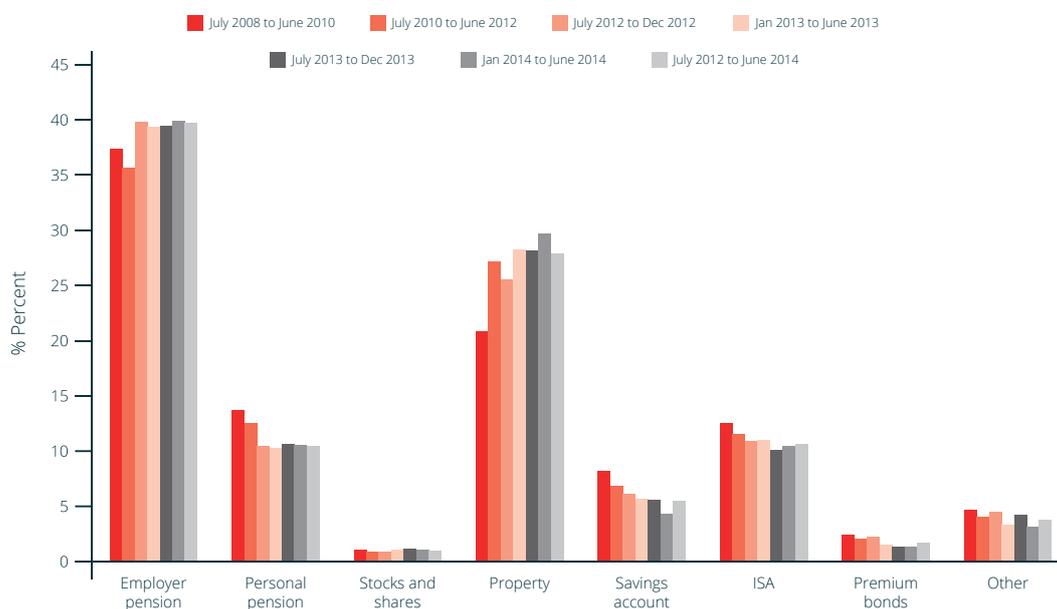
Private landlords in the main have a relatively long-term commitment to the sector (Figure 2.6). About four out of five companies and other organisations expect to be in the sector in ten years' time, and even for private individuals the figure was close to 60%. This is no doubt due in part to the illiquid nature of property investments, and to the high (and increasing) transactions costs associated with sale. Arguably, however, it is because for many the reason for involvement in property (usually in addition to owner-occupation) is that they are looking to help pay for their old age.

There is evidence that a high proportion of private landlords invest in rented property partly or entirely as a form of pension provision—either to provide an income stream in retirement or with the intention of ‘cashing in’ the units to provide a capital sum. Such investment reflects the perceived safety and high returns from property investment and (in recent years) the freeing up of pension savings for investment and the reduction in the cap on standard pension savings.

Reasons for investing in property as pension

The Wealth and Assets survey has consistently shown that respondents view property investment as the second safest way to save for retirement, after employer pensions. In 2014/15 about 40% of respondents thought employer pensions were safest, while 27% chose property (Figure 2.7). The shares for other asset classes including stocks and shares, personal pensions and ISAs were well under half the figure for property.

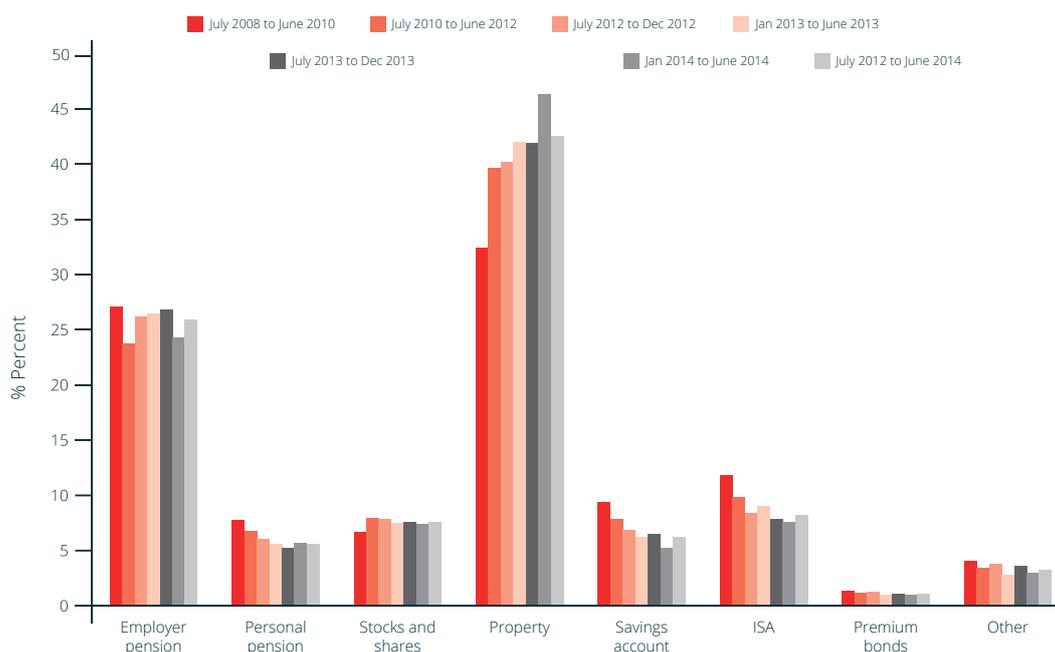
**Figure 2.7: Which option do you think would be the safest way to save for retirement?
Great Britain, 2010 to 2015**



Source: Wealth and Assets Survey, Office for National Statistics

While respondents thought employer pensions were the safest way to save for retirement, they expected the highest returns from property. In 2014/15 nearly 45% of respondents expected that property investment would make the most of their money, compared to 25% for employer pensions. Fewer than 10% of respondents thought other asset classes would provide the best returns (Figure 2.8).

**Figure 2.8: Which do you think would make the most of your money?
Great Britain, 2010 to 2015**



Source: Wealth and Assets Survey, Office for National Statistics

Recent changes in the pension system itself have resulted in increased opportunities for over-55s to invest in property, as well as creating incentives for middle- to higher-income individuals of all ages to do so. The April 2015 changes that allowed savers aged 55 or over full access to their pensions permitted the re-allocation of these savings to property. It was widely forecast at the time that this would result in a mini-boom of Buy-to-Let investment by pensioners, although we lack the data to determine the extent of this. In addition, the reduction in the lifetime cap on overall pension savings to £1 million from 2016 will affect not only high earners but also many individuals on relatively modest incomes. Property investment is one of the two main alternatives for those who want to increase their pension provision but are affected by the cap (the other being stocks and shares, whether held in ISAs or not).

Extent of investment in property as pension

Rhodes and Bevan found in 2002 and 2003 that almost all part-time landlords interviewed regarded their properties as a form of retirement planning (Rhodes and Bevan, 2003). They saw rental property as superior to traditional pensions because it was more flexible and did not rely on stock-market performance. 'Whilst a small number of landlords saw the value in having a spread of different types of investment, most were disillusioned with stocks and shares to the extent that they had either completely divested themselves of such investments, or regarded them as being inconsequential to their future plans' (Rhodes and Bevan, 2003, p. 37).

According to the Private Landlords Survey 2010 (p. 14), 80% of individual private landlords see their properties as 'an investment/pension'. This figure was not broken down further, but other surveys have attempted to tease out the differences. They give widely varying results, probably because of the difficulty of separating more general investment motives from specific pension motives, both in the wording of survey questionnaires but also conceptually. The 2004 CML survey found that the second most common motivation for investing in property was as a contribution to pension provision, with about a quarter of respondents citing this as their reason. A further 52% listed more general investment motives, which would not be inconsistent with future use for pension (Scanlon and Whitehead 2005). And according to the BDRC Landlords Panel in 2012, 81% of respondents said their properties were their pensions. Three-fifths said they planned to live off the rental income, while a quarter planned to sell some or all of their properties as part of their retirement plan (Long, undated).

A number of one-off surveys have been commissioned on this issue by news media and rental-property specialists. These provide some useful indicators, although they should be interpreted with caution. The evidence they provide is mixed: a 2015 survey by HomeLet, for example, found that 'pension investment' was a motive for only 5% of respondents, while a poll commissioned by The Observer reported in 2013 that one person in three planned to receive retirement income from one or more buy-to-let properties (Wright 2013). A 2014 survey of 500 Buy-to-Let investors by Platinum Property Partners found that on average they expected a yearly income of £19,785 from their rental properties, which would make up more than half of their overall retirement income (Platinum Property Partners, 2014).

Private landlords: taxation, regulation and support

Private landlords are subject to income tax on their rental income, Stamp Duty Land Tax when they purchase a property and capital gains tax when they sell. The proposed changes in arrangements for two of these—income tax and Stamp Duty Land Tax—are dealt with in some detail later in this report.

Income tax

Currently, private landlords are taxed at their marginal tax rate on their rental income net of any related expenses. Eligible expenses include repair and maintenance, agency fees and mortgage interest payments. In contrast to many countries there is no depreciation of rental property, although landlords who rent furnished properties are currently permitted to deduct 10% of the annual rent as a 'wear and tear' allowance, without having to demonstrate any expenditure on renewals—in effect a form of depreciation. Rental losses can be set against other rental income, but not against the landlord's income from other sources.

There are three rates of income tax: 20% (on taxable income up to £31,785 in 2015/16), 40% (on income between £31,786 and £150,000) and 45% (on income over £150,000). Rental income is added to landlord's income from other sources, such as salaried employment, to arrive at a figure for total income. The government has announced plans to limit the deductibility of mortgage interest payments, which will have the effect of increasing the income-tax liability of Buy-to-Let landlords who pay higher or additional-rate tax, and of some basic-rate taxpayers. The wear-and-tear allowance will also be limited to receipted expenditures. These changes are discussed in detail in Chapter 4.

Table 2.10 compares income tax treatment of residential rental income in the UK and other major countries. It shows that even before the forthcoming changes, landlords are treated less favourably for tax purposes in the UK. The main differences are that 'negative gearing' (offsetting of rental income against income from other sources) is not permitted in the UK, and that there is no formal depreciation allowance.

Table 2.10: Income tax treatment of residential rental income in various countries

| | Mortgage interest deductible | Lower tax on rental income | Costs deductible | Depreciation allowance | Rental losses offset against other types of income |
|-------------|------------------------------|----------------------------|------------------|---|--|
| UK | • | * | • | • *** (wear and tear furnished only) | |
| Australia | • | | • | • new properties only | • |
| Belgium | • | • | • | • | |
| Denmark | • | • institutions only | • | | • |
| France | • but cannot lead to loss | | • | | • up to limit |
| Germany | • | | • | • | • |
| Ireland | • 75% | | • | • | |
| Netherlands | Business | • | • | • | • |
| | Non-business | | ** | | |
| Spain | • | • | • | | • |
| Switzerland | • | | • | • | • |
| USA | • | | • | • | • with limits |

Colour key:

Tax treatment similar to UK



Landlords treated more favourably than in UK



Landlords treated less favourably than in UK



*Except for 'rent-a-room' allowance

**An imputed return of 4% of net wealth is taxed at a rate of 30%—i.e. effective income tax rate of 1.2% of equity

***Wear and tear allowance of 10% of net rent for fully furnished accommodation

Source: Derived and updated from Kochan and Scanlon, 2011 Table 4

Stamp Duty Land Tax

Landlords purchasing property have until recently paid the same Stamp Duty Land Tax (SDLT) as any other buyer; with no distinction made between types of owner. Rates of SDLT depended on the value of the dwelling. For 'bulk' purchases (say, 100 units in a single building) the tax is calculated based on the median price per unit rather than the total transaction value (which would subject such buyers to the highest tax rate). The government has announced that those purchasing a property that is not for use as their principal residence (that is, landlords and second-home buyers) will pay an additional 3% in SDLT from April 2016. This is discussed in Chapter 4.

Capital gains tax

When a landlord sells a property they must pay capital gains tax of 28% on the difference between the sale value and the original purchase value, adjusted for inflation. The rate does not depend on how long the property was held.

Subsidy

There are no subsidies or incentives offered to small private landlords for investment in or improvement in their properties, apart from those available to all property owners (e.g. the utility companies' green commitment, providing free insulation). Institutional investors have been able to avail themselves of the government's Build to Rent fund and the Build to Rent guarantee scheme (see Chapter 3), designed to support the development of large-scale purpose-built rental-only blocks in single ownership.

Rental support

Private landlords receive £9bn plus of indirect government support through Local Housing Allowance (LHA), the subsidy for low-income tenants living in the PRS. This is commonly known as housing benefit (HB), although strictly speaking HB is the subsidy for social tenants.) LHA subsidies are based on 30th percentile rents in the local area, and are subject to a nationwide cap that depends on the size of the dwelling.

Regulation

There is no regulation of rent levels or rent increases, except indirectly through the operation of the Local Housing Allowance. The standard form of tenancy is an Assured Shorthold Tenancy, which usually lasts six or twelve months. The landlord can require the tenant to leave with two months' notice at the end of the tenancy, or at any time thereafter, without giving a reason. There are other forms of tenancy that give tenants more security but some Buy-to-Let lenders will not permit their borrowers to use them—though this is changing under government and market pressure.

Owners of Houses in Multiple Occupation (generally three or more unrelated adults living in a house—although local definitions vary) must register with their local authorities. Scotland and Wales require all landlords to register, as do an increasing number of local authorities in England. Except for HMOs, properties are not routinely inspected even if there is a registration scheme.

Landlords are obliged to comply with a number of safety standards to do with fire prevention, gas safety, etc. Also from this year landlords will be required to verify tenants' eligibility to live in the UK.

Conclusions

This chapter has given an overview of the current position of the PRS in terms of who lives in the sector; who invests; how government treats households and landlords in the sector and the outcomes in terms of types and locations of properties and the rents charged. It points out how much of this picture depends on surveys with different purposes and sample sizes. The result is a jigsaw which suggests clear variations between groups in the sector, both landlords and tenants, and between those in the PRS as compared to other tenures. However, it can only be indicative of details particularly about how the sector is changing as it becomes the second largest tenure. In particular data relating to the rapid rise in the sector over the last few years is patchy at best, as is detailed evidence on landlord portfolios, indebtedness and longer term objectives.

GROWTH AND CHANGE IN THE PRIVATE RENTED SECTOR

The private rented sector (PRS) had been in decline for nearly a century when it began to grow again in the mid-1990s. The necessary precondition was the 1988 deregulation of tenancies and rents, but the turnaround can be dated to the introduction of the Buy-to-Let mortgage in the mid-1990s. Supply grew mainly through the transfer of dwellings from both owner-occupation and social housing (via Right to Buy), rather than through new build. Some though by no means all PRS dwellings were funded by the new mortgages. None of the government schemes intended to boost institutional investment had a major effect on the sector as a whole, despite pockets of interest.

Demand has grown, reflecting the increase in the 'natural market' for PRS (students, migrants, itinerant young professionals) but also reduced access to owner occupation (mainly for affordability reasons) and social housing. Given the increases in population and households that are projected in the UK, it is almost certain the demand for privately rented accommodation will continue to grow over the next decades. To meet this demand there needs to be continued investment in the PRS

Assessing the expected effects of policy changes requires an understanding of the various types of landlord. The evidence base is thin. It appears that while Buy-to-Let funding is the most common acquisition model, a significant proportion of landlords (around one third) own their properties outright or use a mix of funding.

One reason given for policy changes is to reduce the competition between Buy-to-Let landlords and first-time buyers. The nature and extent of such competition varies enormously across the country. In some markets there is no meaningful competition and first-time buyers on modest incomes can easily afford homes while in others—London particularly—there is strong demand from both landlords and prospective owner-occupiers for particular types of dwelling, especially two-bed flats and houses.

This chapter explores the growth of the PRS since the 1990s and the reasons for that growth. It sets the expansion of the sector within the context of other tenures and considers how the sector has responded to rising demand and static supply in many areas. It considers how various factors have shaped the current tenure mix and provides indications of how that mix might develop in future, particularly in light of government policy initiatives (to which we turn in Chapters 5 and 6).

Starting in 1945 when the sector accounted for more than 50% of dwellings, the size of the PRS stock in the UK fell consistently to around 8% in the latter part of the 1980s. The sector at first grew slowly to around 9% at the turn of the century, then its expansion accelerated. By 2013 it accounted for 18.5% of all dwellings in the UK, 2.2 times the proportion in 2000 and almost 2.5 times the proportion in 2008.

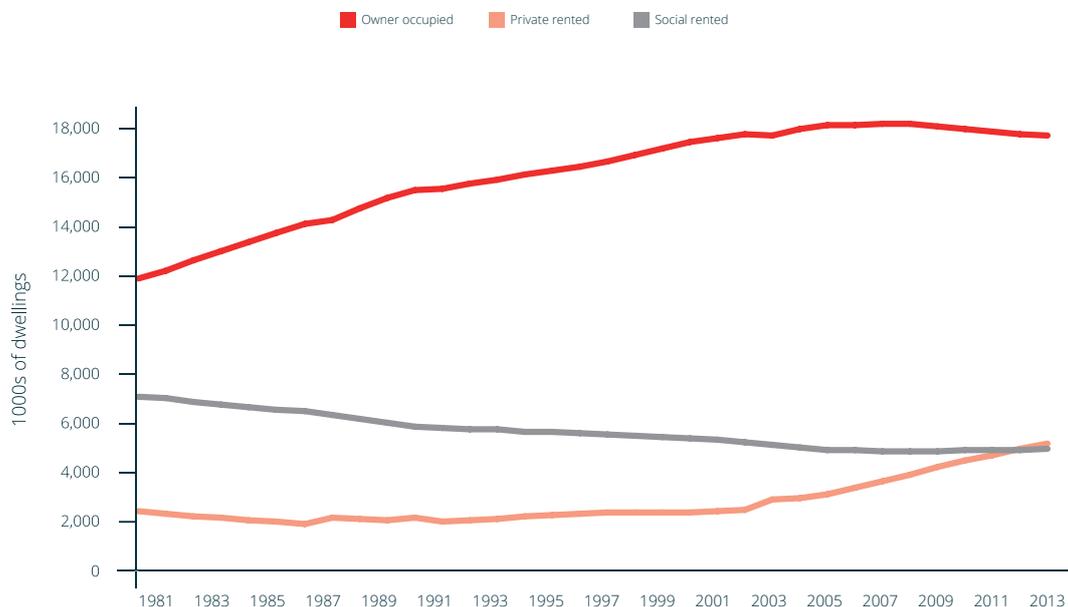


Conditions for growth

We can identify four principal supply-side drivers of the growth of the PRS from the 1980s. The first two were to do with the PRS itself: the removal of rent control and long-term tenure security in the 1980s and the creation, with the Buy-to-Let mortgage, of a dedicated finance channel for small investors in the late 1990s. The third was the long-term impact of the Right to Buy for council tenants. The transfer of dwellings from social to private ownership reduced the supply of council housing as the rate of replacement did not keep pace with sales, leading to an increase in demand for PRS housing. Also, a high proportion of dwellings sold under the Right to Buy eventually ended up in the PRS as the original owners either moved elsewhere and rented them out, or sold to investors (Murie 2015). The fourth source of supply has the move of units from owner-occupation to private rental, in some cases because owner-occupiers moved on and kept the property to rent out, and in others because landlords outbid other purchasers for existing dwellings. Since the turn of the century the number of owner-occupied units has increased slightly, but as a proportion of dwellings owner-occupation has declined from 69% in 2000 to 63% in 2013. In the social sector, absolute numbers fell by more than 400,000 units over the same period and from 22% to 18% of the total stock (DCLG Live Table 101).

Increased demand for PRS housing has come both from positive reasons (desire for easy-access, short-term accommodation) and negative ones (problems of affordability and access to finance for owner-occupation, and long waiting lists, allocation rules that favour priority groups and lack of supply in the social sector). Figure 3.1 shows that in England the number of dwellings in private rental outstripped those in social rental from around 2011. In Annex 2 Figures A.2.1 and A.2.2 give similar information for households.

Figure 3.1: UK housing tenures 1980-2013



Source: DCLG Live Table 101

The 1988 Housing Act marked a real step change that provided the necessary conditions for growth. The main provisions were to introduce an alternative to the indefinite tenancy, and to remove both controls on initial rents and on rent increases for existing tenants. The 1988 Act also completely deregulated the PRS in terms of rents and security. It abolished rent regulation for new leases signed from 1 January 1989. Landlords were permitted to charge full market rent and to increase rents as set out in tenancy agreements rather than by an amount specified by statute. However, tenants could apply to the Rent Assessment Committee if they felt increases were too high. Existing tenancies begun before 15 January 1989 were still 'regulated tenancies' (subject to 'fair rents'). The 1988 Act also introduced the assured shorthold tenancy (a minimum six-month tenancy with no further security of tenure) and required landlords to give tenants a minimum of two months' notice.

The government introduced an important short-term tax advantage to the PRS in 1988. It extended the Business Expansion Scheme, which gave incentives to small investors to get involved in more risky business start-ups, to landlords of newly constructed dwellings let on assured tenancies for the period 1988 - 1993. During that period some 81,000 dwellings were added to the PRS stock, although a high proportion of the units provided were only available to students (Crook et al, 1995; Hughes, 1995).

In 1997 the assured shorthold tenancy (AST) became the default form of tenancy in the PRS. The AST permits the landlord to regain the property from tenants with two months' notice at the end of the lease (usually 6 or 12 months) or at any time thereafter without requiring a reason. Now landlords had certainty that they could charge a market rent and get property back from tenants, which significantly reduced the risk of letting.

The very limited security of tenure introduced by the AST together with increasing competition among mortgage lenders created the conditions for the mortgage industry to lend more easily to private landlords. Following a 1994 initiative by the Association of Residential Letting Agents, the Buy-to-Let mortgage became available from July 1996 to private landlords to purchase property to let. The loans were usually interest-only, based on projected rental income, with loan-to-value ratios of up to 85% and interest rates little above those for owner-occupiers (Rhodes, 2006; Ball, 2004).

In 1980 the PRS consisted of some 2.1 million units, somewhat less than 12% of the total stock. In 1996 the number of units was almost exactly the same, but made up only just over 10% of the stock. However, in the interim there had been further decline, to as low as 1.8m homes in the mid-1980s, and this loss was only slowly offset from the early 1990s. Even then, Crook and Kemp (1996) pointed out that half of the expansion during the early 1990s could be explained by 'property slump landlords' who were unable or unwilling to sell at that time because of the state of the owner-occupied housing market. Thus the large growth in the sector comes after the mid-1990s when Buy-to-Let mortgages became available.

Importantly, an increase of only some 300,000 units from the late 1980s to the turn of the century does not suggest that the system was functioning well. After the 1989/90 housing crisis nearly two million homeowners were in negative equity; owner-occupation rates among households in their twenties were dropping rapidly; and the PRS increasingly housed those who would traditionally have been in the social sector. These factors all contributed to the growth of the PRS during that time. But although the trends had become clear, the adjustment process was slow.

Policies to stimulate institutional investment

Since deregulation, a major focus of government policy has been to stimulate the supply of private rental dwellings by institutions rather than individual investors, even though the latter dominated – and continue to dominate – the PRS. In addition to the BES scheme mentioned above, Housing Investment Trusts (HITs) were introduced in 1996 in order to bring pension and other long-term funds into privately rented housing, including existing lettings (Crook, et al., 1998; Crook and Kemp, 2002). However, major investors did not see them as worthwhile and no HITs had been set up by 2010.

The introduction in 2005 of legislation to allow UK Real Estate Investment Trusts (REITs) based on the US model made it possible to create liquid and publicly available property investment vehicles for sale to a wide range of investors. The aim was to encourage institutional and professional investment in both commercial real estate and privately rented property (Ball and Glascock, 2005). UK-REITs have been allowed to operate since January 2007. Most invest in commercial and retail property, although a small number also invest in rental accommodation. As yet only a very few REITs invest solely in residential property.

The policy goal of attracting institutional investment into private rental housing once again came to the fore after the 2010 change of government. The March 2011 Budget contained a set of measures aimed at creating a more tax-efficient approach to large scale investment through REITs (Stephens and Williams, 2012). However, of themselves these changes did not stimulate an incremental flow of institutional investment into new housing built specifically for rent. After an independent review of ways to attract institutional investment into the sector (Montague, 2012), the policy priority shifted to the development of a new 'Build to Rent' scheme. This term describes large-scale purpose-built rental-only blocks that are in single ownership, an industry model common in many European countries but not seen in the UK since the 1930s (Pawson and Wilcox, 2013; Scanlon et al., 2013). The first group of Build to Rent projects, announced on 16 April 2013, will contain up to 10,000 new homes. In addition the government announced a £10 billion debt-guarantee scheme to support new Build to Rent developments in the UK (Bate, 2015). Overall, these two measures aimed to reduce the costs and risk of finance at different stages of development and ownership of new private rental dwellings.

Despite these efforts, the role of institutional investors in the PRS is still negligible. Most of the institutional investments in large-scale rented housing are in London. A recent survey of institutional investors by the Investment Property Forum suggested that of a total £180 billion in property assets held by 42 institutions, only four per cent was invested in residential, and of that less than half was in PRS assets (IPF 2014). This was an extremely small amount compared to the total estimated £2.7 trillion under management by UK institutions (CBI, 2013).

A number of studies have looked at why institutional investors have not become significant players in the residential property market and have generally identified a common set of factors (Daly, 2008; HM Treasury 2010; Hull et al., 2011; Scanlon et al., 2013):

- the difficulty that developers of PRS-specific buildings have competing for land against owner-occupation;
- a shortage of development finance;
- low risk-adjusted yields;
- lack of investor experience in the sector together with very limited performance data on which to base decisions;
- the need for scale: Savills (2014) comments that the dearth of large-scale purpose-built private rental stock and the operational platforms to run them is the main barrier to investors in PRS (see also Milligan et al., 2013);
- negative investor and local government attitudes to the sector: it has been suggested that some local authorities have not adopted the pro-growth approach of the National Planning Policy Framework and have blocked the supply of new housing in their areas (CBI, 2013);
- poor quality and expensive management;
- reputational risk; and
- uncertainties around the regulatory and taxation regimes.

Continued increasing demand - and how it has been met

So where has the growth from the mid-1990s come from?

Rugg and Rhodes, in a 2008 report for DCLG, identified the most important factors generating demand for private renting (Rugg and Rhodes, 2008). They were:

- growth in student numbers;
- increased inward migration;
- higher levels of relationship breakdown;
- increased demand that would otherwise have been catered for in the social rented sector;
- growth in the numbers of younger tenants renting for 'lifestyle' reasons; and
- increasing affordability problems for those wanting to access home ownership.

Some of these elements of demand arise from choice while other are clearly constraints stopping people choosing a more favoured tenure (see Annex 2 for more detail) but all lead to higher demand for private rental. This increasing demand was met in part from newly constructed dwellings, but mostly from the transfer into private rental of existing units that had been in the social and owner-occupied sectors. Although some 220,000 dwellings were built for the social sector over the period 1997- 2010, the number of units in that sector fell by nearly 500,000 as tenants exercised their Right to Buy and other units were lost to demolition and sale. Subsequent studies have shown that a significant minority of units transferred into owner-occupation later moved into the PRS (Inside Housing, August 2015).

Equally, 1.6 million private units were built but owner-occupation rose only by around a million. In part this adjustment reflected the growing number of Right to Buy dwellings that moved into private renting—it is currently estimated that 40% of all Right to Buy properties are now let privately (House of Commons 2016). In part, especially after the global financial crisis, units that could not be sold by owner-occupiers instead were rented out. Some proportion of the increase comes from landlords who do not wish to be in the sector for the longer term, but much reflects the fact that expected returns from residential property exceed those from alternative investments in a period of low interest rates and increased risk. It is also clear that for developers, the returns from building private rented stock usually cannot compete with the returns of sale into owner-occupation. The main source of new PRS supply is not new-build but the existing stock.

Overall in the period 1997 - 2010 the number of private rented homes increased by some 85%, and as a proportion of the stock grew from just over 10% to about 17%. By 2010 there were some 3.9 million privately rented homes – a figure last seen in the mid-1960s. Far more of these additions were newly built homes than had been the case since the 1930s. Although exact numbers are not known, a government analysis (HM Treasury, 2010) based on a sample of Buy-to-Let mortgages taken out between 2004 and 2007 suggested that Buy-to-Let might have contributed to the purchase of 35,000 units a year, or around a fifth of all new completions at that time. However, CML data suggest that in 2015 only around 6% of all Buy-to-Let mortgages were secured on new property. This implies that they supported the purchase of just 7,000 units, less than a third the Treasury estimate (CML estimate, based on Buy-to-Let Mortgage Survey).

The number of Buy-to-Let mortgages increased strongly from the late 1990s. Figure 3.2 shows new loans since 1999, giving the total number (left-hand scale) and value in £ millions (right-hand scale). This shows the dramatic growth in the market: in 1999 there were fewer than 50,000 new loans but by 2007 this had grown by a factor of seven to 346,000. The increase in values was even greater, with gross advances of £27.4 billion in 2014 – almost nine times the level of 1999.

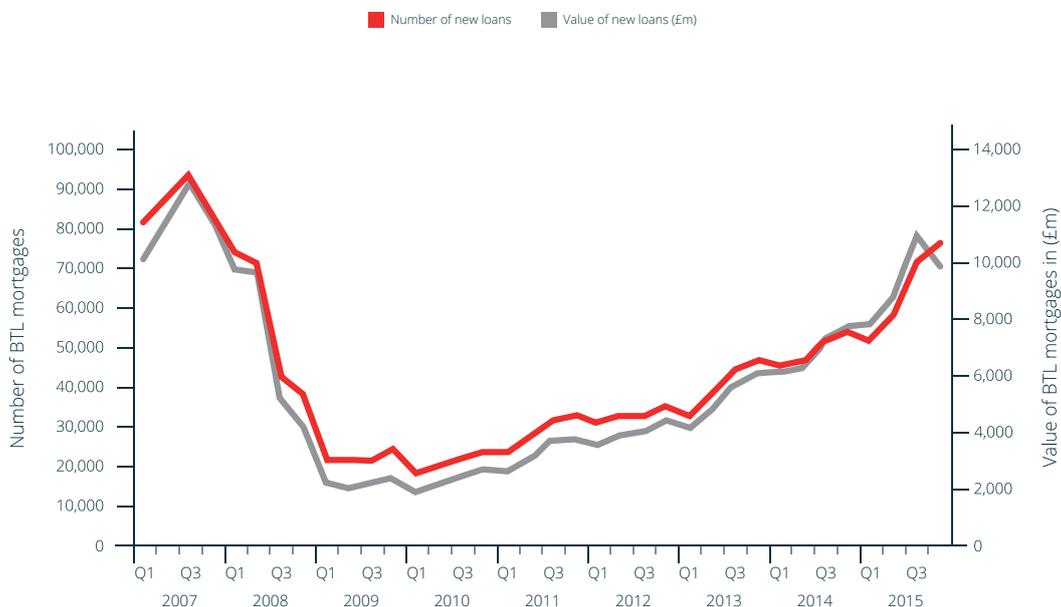
Figure 3.2: Number and value of new Buy-to-Let mortgages, 1999-2014



Source: CML Table MM17

There was a very sharp drop in the wake of the global financial crisis. Recovery from this low base began in 2009 and has been accelerating since 2012, but the number and value of new loans have yet to regain the levels seen in 2007 (Figure 3.3).

Figure 3.3: Number and value of new Buy-to-Let mortgages, 2007-Q3, 2015

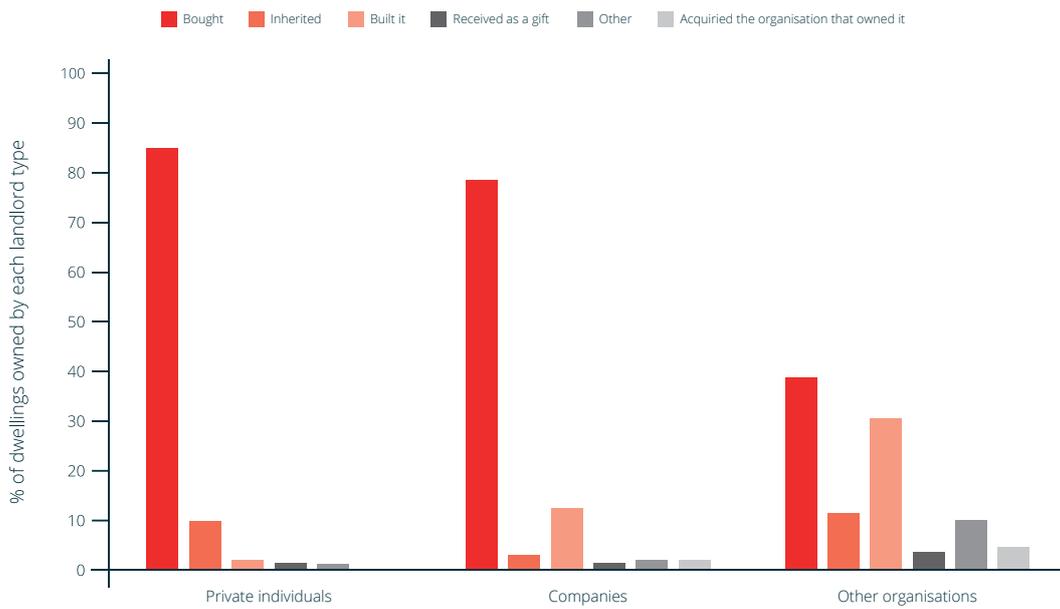


Source: CML Table MM17

Loan-to-value ratios for Buy-to-Let loans have been on a downward trend since the financial crisis, according to surveys, and landlords reported in 2014 that they borrow on average about 60% of the purchase price of properties. The average LTV of entire portfolios was lower, as many landlords have some un-mortgaged properties, and has also fallen since 2007 (Carey-Jones 2015).

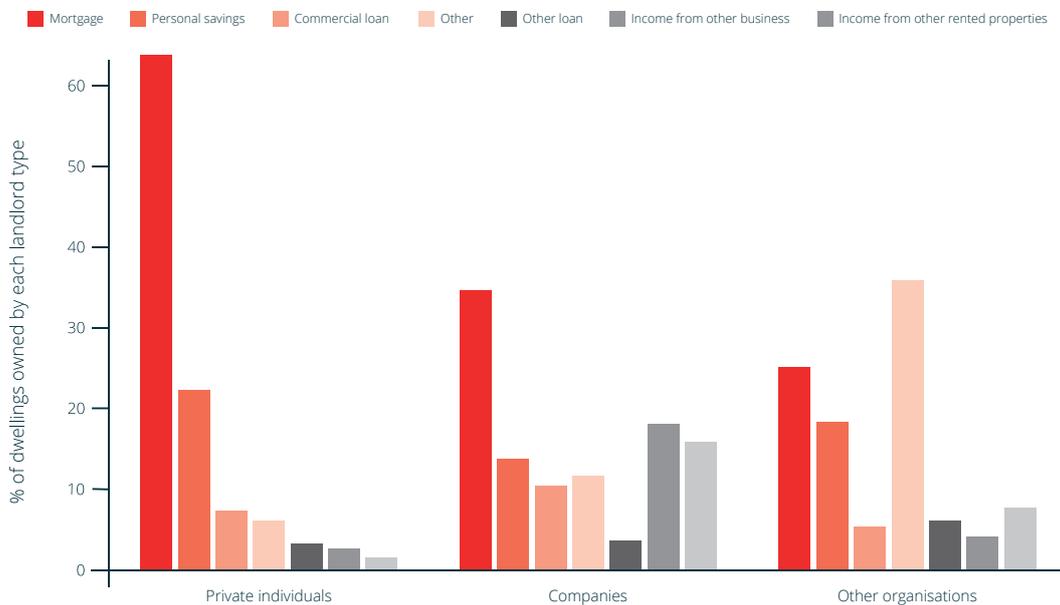
The DCLG Private Landlords Survey 2010 shows that the vast majority of all properties were purchased in the marketplace (Figure 3.4). The proportions of properties inherited, received as gifts or acquired in other ways which probably did not involve debt finance are all relatively small. Building the property might have involved external funding, but of a different sort. So the starting point is that perhaps 70% of new acquisitions involved a market purchase.

Figure 3.4: Method of acquisition by landlord type



Source: Private Landlords Survey 2010

Figure 3.5: Sources of finance for acquisition by landlord type



Source: Private Landlords Survey 2010

Among private individuals more than 60% used a mortgage to purchase (Figure 3.5). Not all of these would have been Buy-to-Let, and indeed many would have been acquired before that type of mortgage existed. A further 10% or so used other loans. But this does imply that some 75% of the stock of investment properties in 2010 had been bought with debt finance.

Among companies the proportion involving debt finance was much less. The proportion of company borrowing has probably increased since this survey, because a higher proportion of Buy-to-Let purchasers are now constituted as companies. Other organisations would generally not be in the Buy-to-Let market.

Looking at the trends in the numbers of Buy-to-Let mortgages we see that since 2007 the numbers per annum have ranged from as high as nearly 350,000 to a low of under 100,000 (Table 3.1).

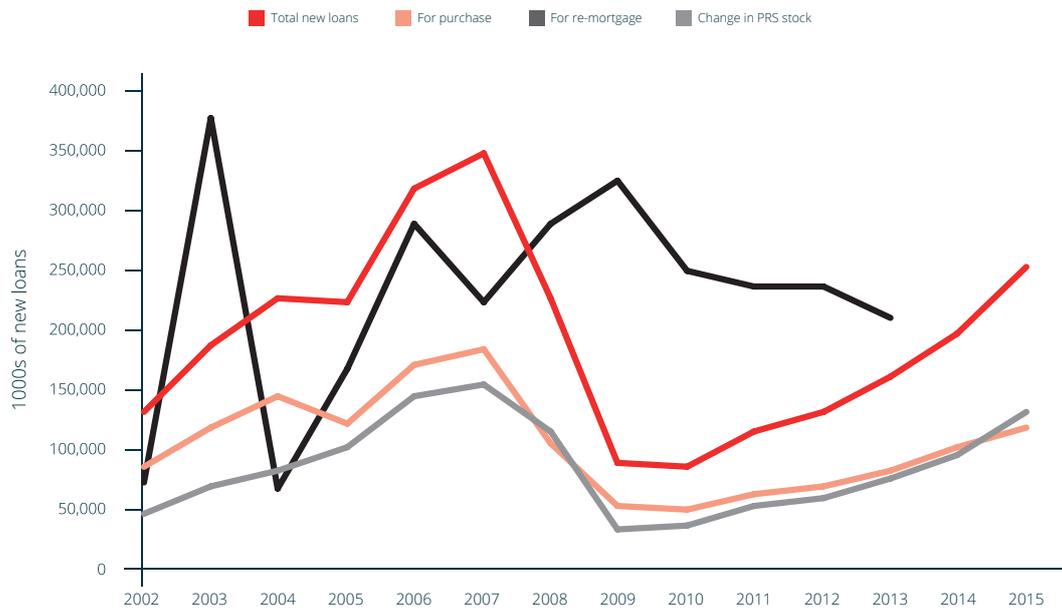
Table 3.1 New Buy-to-Let mortgages (1999-2015) and split between purchase and re-mortgage (2002-2015)

| Year | Number of loans | £ millions gross advances | | | Percent for re-mortgage |
|------|-----------------|---------------------------|--------------|-----------------|-------------------------|
| | | Total | For purchase | For re-mortgage | |
| 1999 | 44,400 | 3,100 | | | |
| 2000 | 48,400 | 3,900 | | | |
| 2001 | 72,200 | 6,900 | | | |
| 2002 | 130,000 | 12,900 | 8,030 | 4,130 | 32 |
| 2003 | 187,600 | 20,300 | 11,600 | 7,460 | 37 |
| 2004 | 226,000 | 24,100 | 14,060 | 8,490 | 35 |
| 2005 | 223,100 | 25,600 | 12,630 | 11,670 | 46 |
| 2006 | 319,200 | 38,000 | 19,590 | 17,120 | 45 |
| 2007 | 346,000 | 44,600 | 23,100 | 20,640 | 46 |
| 2008 | 225,300 | 27,600 | 12,210 | 14,610 | 53 |
| 2009 | 88,400 | 8,200 | 4,530 | 3,390 | 41 |
| 2010 | 85,200 | 8,700 | 4,650 | 3,960 | 46 |
| 2011 | 114,900 | 12,600 | 6,200 | 6,400 | 51 |
| 2012 | 130,200 | 15,200 | 7,400 | 7,600 | 50 |
| 2013 | 161,000 | 20,800 | 9,300 | 10,700 | 51 |
| 2014 | 197,700 | 27,200 | 12,400 | 14,500 | 53 |
| 2015 | 252,200 | 37,900 | 15,600 | 21,900 | 58 |

Source: CML Table MM17

In the period before 2008 the number of mortgages exceeded the net additions in the final couple of years by a considerable amount – in 2007 by 55% (Figure 3.6). From 2008 the net increase in the PRS began to exceed the number of new mortgages, initially by increasing amounts and then as the numbers of mortgages grew again came back closer to the net increase. By 2013 net additions were still above the number of new mortgages by around 30%. However, in 2014 and particularly in 2015 the growth in Buy-to-Let mortgages jumped – by 23% in 2014 and 28% in 2015, with re-mortgaging increasing by 28% and 38% respectively. Thus to some extent the picture prior to 2008 is being repeated.

Figure 3.6: New UK Buy-to-Let loans for purchase and re-mortgaging and change in stock of PRS dwellings, 2002-2013



Source: CML Table MM17 and DCLG Live Table 101

This demonstrates that not all the growth in the PRS is attributable to additional Buy-to-Let mortgages. Households can let out previously owner-occupied properties (so-called 'let to buy') or fund purchases by increasing indebtedness on their owner-occupied home. It is also clear that a large proportion of Buy-to-Let mortgages, especially before the crisis, were re-mortgages where the money was perhaps used for other purposes. New Buy-to-Let mortgages do not necessarily generate net additional PRS stock; equally, additional stock can be generated without the use of Buy-to-Let mortgages, not only because a significant number of landlords are cash purchasers but also because there are other sources of debt finance. What is also clear is that institutional investment has remained negligible throughout the period although there are now clear signs of potential interest.

The BDRC survey suggests that the role of Buy-to-Let in future purchases is expected to be very similar to the past - over 60% of those with four properties or fewer expect to use a Buy-to-Let mortgage, while a quarter of all types of landlord expect to release equity from other properties to enable the next purchase. These methods pose very different risks and are not mutually exclusive. However, between a quarter and a third of those looking to buy another property are expecting to do so without recourse to any form of debt finance.

Locating Buy-to-Let within the PRS

As noted above, private landlords can acquire their properties in a variety of ways. Many own dwellings outright, having inherited them or purchased without using debt finance. There are then those who borrowed initially, either with a Buy-to-Let mortgage or some other source, but have since paid off their debt. We know next to nothing about this group. Then there are those who currently have one or more Buy-to-Let mortgages and those who intend to buy properties using such a mortgage in future. It is at this group that government policy appears to be directed.

The term Buy-to-Let also has many meanings in the literature. In the general PRS context it tends to refer to anyone who purchased a property with the intention of letting it out. This broader use of the term covers those using a Buy-to-Let mortgage but also includes many landlords who used other sources of funds. However it excludes what is now seen to be an important (if relatively small) group known as 'let to buy' - i.e., those letting out a property they already own and using the rental income to purchase another in which they may live as owner-occupiers (or indeed also let out).

In the current policy context the interest is mainly on Buy-to-Let mortgagors strictly defined. Even within this group there are those who have paid off their original mortgage(s); those who are still mortgagors but only on part of their portfolio (and may use additional mortgage finance on existing properties to fund new acquisitions); and those who have a Buy-to-Let mortgage on each property whether they own only one or have multiple holdings. In order properly to assess the levels of indebtedness and risks involved, each category should be considered separately. However, there is very little evidence about the distributions of portfolio sizes, overall debt, and the proportions of properties covered by Buy-to-Let mortgages. On the evidence of one survey (BDRC), 30% own their property(ies) outright; this is generally corroborated by other surveys. Some 44% of BDRC respondents own with the help of a Buy-to-Let mortgage (by implication on all properties in their portfolios) and 26% own some units outright and some with a Buy-to-Let mortgage. This appears to be consistent in general terms with other data sources.

It is very clear that re-mortgaging is an important factor determining the risks involved, but we know little about patterns of re-mortgaging among individual landlords. Table 3.1 suggests that more than half of Buy-to-Let lending in 2015 was re-mortgaging, but in portfolio terms the CML survey only provides data of other borrowing from the same organisation and these questions are answered by less than 50% of respondents. Other sources are very limited. This, and the general paucity of data about landlords' financial and investment models, means it is difficult to formulate evidence-based assessments of the risks or levels of debt associated with landlords' eventual decisions.

It is quite clear that there are a number of different Buy-to-Let markets and this is key to understanding landlord behaviour both in the upturn and the downturn. In areas with high and sustained house-price appreciation, landlords are more likely to see their properties as equity investments with clear resale prospects, although they require rental income to cover mortgage costs and produce an annual return. Elsewhere, notably in markets where house-price growth is slower, property is purchased for the rental return with the question of capital uplift (or resale) being much more uncertain. These differing market circumstances affect the price points where landlords feel able to bid into the market. In lower-growth markets landlords are less likely to be bidding against first-time buyers, who are more likely to be trying to enter stable and growing markets. In these stronger markets the competition between first-time buyers and landlords is clearer due to the overall pressure on prices. Landlords are aware of this, and know that such pressure helps ensure a ready demand for renting as well as potential buyers when they come to sell. So in London and other vibrant markets there is stronger competition around some types of homes, in particular two-bedroom flats and houses.

Bracke (2015) argues that Buy-to-Let investors target areas where there is already a strong private market. He compared the percentage of Land Registry transactions classified as Buy-to-Let against the percentage of PRS stock by region, and found a clear relationship: Buy-to-Let activity was more common in London than elsewhere, and PRS dwellings formed a higher proportion of the stock. Looking at dwelling type, he found that flats were more likely than other types of dwellings to be bought by Buy-to-Let investors, though in some regions terraced houses are probably equally important. The recent BDRC survey shows that terraced homes dominate portfolios in the North, Midlands and Wales, while in London and Scotland flats are most common.

Conclusions

This chapter has shown how deregulation in the 1980s prepared the way for potential growth in the PRS but did not of itself generate that growth. Rent deregulation and very limited security of tenure together with specific government initiatives were not enough to lead to net new investment either from institutional or individual investors. Yet as early as the late 1980s there were signs of increasing demand for privately rented accommodation, particularly from younger households and those unable to gain access to social housing. This lack of supply response was due to a complex mix of constraints, incentives and changing requirements, including the fact that in the 1980s there were many landlords who wanted to leave the sector.

It was only with the introduction of Buy-to-Let mortgages in the mid-1990s that net new investment in private renting could be observed. The introduction of the Buy-to-Let mortgage was clearly enabling and changed the nature of the market. But more fundamental issues around demographic change, affordability, access to mortgage credit, risks both for working households and investors, the available returns on other investment and the outcomes of government macroeconomic policy lie at the heart of the growth of the sector.

Even so, much of the growth in PRS stock has come from other tenures with only perhaps 15 – 20% of the increase coming from newly built dwellings. Importantly institutional landlords still do not see the conditions necessary for large scale investment in the sector – instead, debt free individual purchasers and those using Buy-to-Let mortgages have been prepared to invest.

ADDRESSING THE GOVERNMENT'S CONCERNS

The government and the Bank of England have asserted that Buy-to-Let investors compete unfairly with first-time buyers and that in a downturn they might sell properties into a falling market, exacerbating the situation. There is also a long-term preference for a rented sector owned and managed by institutions rather than private individuals. These concerns seem to lie behind the various proposals to curb the sector.

Every year since 1999 more loans went to first-time buyers than Buy-to-Let investors in all regions, including London. Landlords can access interest-only mortgages, now almost unavailable to owner-occupiers, but on the other hand LTVs for investors are generally lower. The (limited) research into direct competition between investors and putative owner-occupiers has found that nationwide, only a minority of sales to landlords involved bids from both types of buyer.

The forthcoming changes in regulations will not affect large company or corporate landlords. However, even if this subsector were to grow very rapidly it would still account for only a small proportion of the PRS stock.

The Bank has based comments about landlord behaviour on results from a general household survey. In more targeted surveys landlords tend to say they are more likely to buy than to sell, whatever the state of the market. Increases in Stamp Duty Land Tax (SDLT) can be expected to reduce landlord purchases, and mortgage tax changes will reduce returns for many landlords but will not cause them to sell up en masse. Decisions about the role of residential property in overall portfolios will depend on returns to other asset classes, and any rebalancing will take place over a number of years. The evidence from previous downturns does not support the official view.

Introduction

We have set out in some detail the evolution of the private rented sector (PRS) and within that the Buy-to-Let mortgage sector. We have highlighted some of the terminological difficulties that exist in developing tight and shared definitions of the two sectors. We have also flagged up the significant data gaps which limit a full understanding of the PRS as a whole and the Buy-to-Let market in particular. When the Bank of England was before the Treasury Select Committee and the discussion turned to Buy-to-Let, Martin Taylor, external member, Financial Policy Committee, BoE said in response to a question from Chris Philp, MP,

We are expressing mild concern about Buy-to-Let. We note that it has different characteristics from owner-occupied. We do not understand its characteristics quite so well, because it has not been going so long. We do not have historical data.

(House of Commons, 26th January, 2016)

In this chapter we examine the arguments put forward over recent months about policy developments including:

- The Summer Budget announcements on reducing landlords' entitlement to mortgage interest relief and the wear and tear allowance;

(<https://www.gov.uk/government/publications/restricting-finance-cost-relief-for-individual-landlords/restricting-finance-cost-relief-for-individual-landlords> and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/447461/150715_Wear_and_tear_condoc.pdf)

- The Autumn Statement announcement that landlords would be liable for higher rates of Stamp Duty Land Tax
(<https://www.gov.uk/government/consultations/consultation-on-higher-rates-of-stamp-duty-land-tax-sdlt-on-purchases-of-additional-residential-properties/higher-rates-of-stamp-duty-land-tax-sdlt-on-purchases-of-additional-residential-properties>)
- Consultation on the powers of direction for the Financial Policy Committee
(<https://www.gov.uk/government/consultations/consultation-on-financial-policy-committee-powers-of-direction-in-the-buy-to-let-market/financial-policy-committee-powers-of-direction-in-the-buy-to-let-market>)

Arguments in favour of curbs on the Buy-to-Let sector

Reasons for curbing Buy-to-Let, according to various policy announcements, include the following:

- Buy-to-Let investors have crowded out first-time buyers;
- a sustainable, high-quality PRS should be dominated by professional landlords with large holdings; and
- the Buy-to-Let sector is a potential cause of economic instability as landlords tend to invest in the upturn and sell in the downturn, thus putting undesirable pressure on prices (up or down).

We explore each of these assertions in turn. As a prelude, we reflect on why the government has made what many see as a sudden 'u-turn'. In coalition housing minister Grant Shapps MP espoused tenure neutrality, while a January 2015 consultation paper provided evidence of the government's positive stance on Buy-to-Let:

....buy-to-let borrowers tend to be acting as a business. The government is committed to introducing FCA regulation only where there is a clear case for doing so, in order to avoid putting additional costs on firms that would ultimately lead to higher costs for borrowers.

.... the directive does recognise that buy-to-let lending is not the same as lending to individuals who are buying their own home, and provides member states with the option to exempt buy-to-let from the detailed requirement....The government is proposing to use this option to put in place the minimum requirements to meet the UK's legal obligations, as it is not persuaded of the case for the conduct regulation of buy-to-let.

(consultation paper on the Implementation of the EU Mortgage Credit Directive, issued January 2015)

Yet in the following 12 months there have been several major interventions. It is clear that the continued shrinkage of the owner-occupied sector has been the driving factor and along with it growing political pressure for a response on the home ownership side. The government seems to have taken the view that this decline was to an important degree caused by the rise of the PRS/Buy-to-Let sector, thus justifying the imposition of new constraints.

The arguments being advanced by both the government and the Bank of England have strong echoes of the sustained commentary emanating from the Reserve Bank of Australia and others around the world (see Reserve Bank of Australia, 2015). The Reserve Bank of New Zealand has been making similar remarks and indeed has made a policy intervention in the Auckland housing market (Reserve Bank of New Zealand, 2015). These examples plus recent moves by the Basel Committee of the Bank for International Settlements do suggest a growing focus on this area. The global Financial Stability Board issued its paper on Principles for Sound Residential Mortgage Underwriting Practices in 2012 and has maintained an interest in the Buy-to-Let area, though has not published any warning signals. The Bank of England stance is therefore in line with the position of other central banks and regulators.

In the recent Treasury Select Committee referred to above, the Bank sought to offer a balanced commentary in response to questions about the access of Buy-to-Let investors to interest-only loans and the fact that they are not subject to a personal income test. It highlighted the fact that Buy-to-Let investors must put down bigger deposits than prospective owner occupiers. However, Martin Taylor did conclude 'I would agree the Buy-to-Let buyer does seem to have an advantage in executing the transaction.'

One reason why Buy-to-Let mortgagors may anyway be seen to have an advantage over first-time buyers outwith the issues of taxation and regulation is that Buy-to-Let mortgagors are in a similar position to existing owners in having a reasonable amount of equity in place such that the loan to value ratios are often well below the 75% usually regarded as the norm. Like existing owner-occupiers they are in a position to outbid first-time buyers. Moreover where the investor uses cash they are able to offer a speedier transaction than one where approval for a mortgage loan must be secured.

First-time buyers (FTBs) v Buy-to-Let purchasers

The extent to which Buy-to-Let purchasers might actually crowd out first time buyers has been the subject of much comment but little serious analysis. There are a number of aspects to the issue. First, there is the relative scale of the two markets – on the basis of both the number and value of loans (one measure for which there are data) we can see that the first-time buyer market is much bigger than the Buy-to-Let market and indeed has recovered more strongly (Table 4.1).

Table 4.1: Market for first-time-buyer mortgages and Buy-to-Let loans, 1999 to 2015

| | | 1999 | 2005 | 2010 | 2015 |
|-----------------------------------|------------|---------|---------|---------|---------|
| First-time-buyer mortgages | Number | 592,400 | 363,800 | 199,400 | 311,700 |
| | Value (£m) | 34,009 | 39,880 | 24,100 | 45,000 |
| Buy-to-Let mortgages | Number | N/A | 120,460 | 49,420 | 100,300 |
| | Value (£m) | N/A | 12,630 | 4,650 | 12,200 |

Source: CML

It is however self-evident that there will be markets where the two groups compete. As noted in Chapter 2, private renting is much more spatially concentrated than owner-occupation and PRS dwellings are more likely to be flats, either purpose built or converted. Thus in some locations - notably central urban areas - and for some types of property, Buy-to-Let will set the price, especially given the ability of prospective owner-occupier purchasers to go to other areas and house types which are traditionally more suited to that sector. This is a segmented market which requires detailed analysis to unpick.

A recent Countrywide/Sunday Times analysis (31/1/16) looked at 210,000 offers made for 61,000 properties sold over the past 12 months to determine whether landlords had outbid first-time buyers. Competition was most intense in London (Table 4.2), where 46% of sales to investors were at the expense of prospective owner occupiers (the figures were 37% in the South East, 25% in the West Midlands – the UK average was 36%). This suggests that in only a third of sales to investors was there a competing bid from a prospective owner occupier. Of course some of the latter may have decided there was no point in attempting to compete, but it certainly suggests there are markets where the overlap is not great and others where landlords are the main market players.

In a Bank of England paper, Bracke (2015a) finds that over the period 2009-2014, Buy-to-Let investors in the UK on average paid around 1% less than other buyers and that where the rental markets were smaller and less active the discount rose (also that the scale of discount was directly related to overall market conditions – the stronger the rental market the lower the discount).

⁴See FSB summary; <http://www.fsb.org/wp-content/uploads/Annex-VI-Summary-of-additional-questions-on-recommendation-12.pdf>

Table 4.2: Prices paid by investors and first-time buyers

| | Proportion of investor purchases without counter-offer from owner occupier | Average investor purchase price | Difference between investor offer and highest owner occupier offer | Proportion of sales to investors |
|-----------------------------|---|--|---|---|
| West Midlands | 75% | £114,773 | 1.3% | 16.7% |
| North East | 71% | £111,890 | 2.8% | 13.9% |
| Wales | 71% | £133,008 | 3.4% | 15.5% |
| Yorkshire and Humber | 67% | £112,321 | 2.8% | 12.7% |
| North West | 67% | £102,056 | 3.2% | 12.4% |
| South West | 66% | £170,869 | 1.7% | 14.9% |
| East Midlands | 66% | £108,850 | 2.3% | 16.0% |
| East of England | 64% | £165,025 | 2.2% | 12.7% |
| South East | 63% | £214,904 | 1.7% | 15.7% |
| London | 54% | £436,103 | 1.8% | 13.2% |
| UK | 65% | £191,982 | 2.3% | 14.9% |

Source: Countrywide

Table 4.3 looks in more detail at the overlaps between the FTB and Buy-to-Let markets insofar as the data allow. Given the different spatial concentrations of demand in the two sectors it is a pity that no more detailed comparison is possible. These data for the third quarter of 2015 give a fairly typical breakdown comparison between the two sectors. Buy-to-Let lending is roughly a third of the size of FTB lending (by number of loans) though it is clear that this varies by country and region. In London there are nearly half as many Buy-to-Let loans as FTB loans, whereas in much less pressured markets this proportion is around 20%.

This again suggests that competition between sectors is more intense in some markets than others. Buy-to-Let loans have lower LTVs (typically 75%) than FTB loans reflecting the restrictions imposed by lenders. Indeed recent industry data for November 2015 show that 21% of loans for Buy-to-Let purchase were at LTVs of 65% or below, 26% at between 65 and 75%, 14% at 75 and 39% at LTVs over 75% - almost all in the 75-80% category. Thus over three-fifths of Buy-to-Let loans had LTVs of 75% or lower. However Buy-to-Let investors can access interest-only loans in ways most FTBs cannot though this market is slowly re-opening. In addition quite large numbers of investors use cash to make their purchases -Bracke (2015b) estimates this at 50% although it is clear it varies over time - and this of itself advantages investors over FTBs.

In summary while competition between these two sectors undoubtedly exists, especially in central urban areas, it is not a universal problem. Constraining the Buy-to-Let sector will not in itself solve the problem of declining home ownership and indeed may mean that the shrinkage of the PRS forces erstwhile FTBs to live with family and friends for longer instead of establishing independent households.

Table 4.3: Competition between investors and first-time buyers

| | | UK | England | Greater London | South East | West Midlands | North East | Scotland | Wales | N. Ireland |
|--|-------------|---------|---------|----------------|------------|---------------|------------|----------|---------|------------|
| First-time buyer loans | Number | 84,200 | 70,400 | 12,400 | 16,400 | 6,900 | 3,000 | 8,200 | 3,600 | 2,000 |
| | Value (£m) | 12,900 | 11,420 | 3,280 | 3,100 | 850 | 370 | 890 | 390 | 180 |
| | Average (£) | 153,206 | 162,215 | 264,516 | 189,024 | 123,188 | 123,333 | 108,536 | 108,333 | 90,000 |
| Buy-to-Let loans | Number | 27,693 | 24,778 | 6,061 | 4,818 | 2,243 | 904 | 1,618 | 837 | 407 |
| | Value (£m) | 3,733 | 3,544 | 1,493 | 729 | 204 | 61 | 128 | 69 | 26 |
| | Average (£) | 134,799 | 143,030 | 246,329 | 151,307 | 90,949 | 67,478 | 79,110 | 82,437 | 63,882 |
| Buy-to-let as % of First-time buyer loans (number) | | 33% | 35% | 49% | 29% | 33% | 30% | 19% | 23% | 20% |

Source: Paragon/CML

'Amateur' vs 'professional' landlords

As discussed earlier, the government has put considerable emphasis on its wish to see the development of an institutionally funded and highly professionalised private rental sector. By implication the argument seems to be that amateur landlords are less likely to offer high quality services and that institutional investors will not only offer newly built homes but also professional management. This is quite a difficult argument to challenge because even though it might be true of institutional investors we have yet to see the scale of investment to allow us to evidence the case. It makes sense that such investors will do this as their focus is on the rental return – a running yield – that can support the pension liabilities that often underpin their investments.

Many experts suggest that a good way to speed up new residential construction is to increase the proportions going into the rental market (and implicitly into institutional hands). But even if this does happen, new build will comprise only small proportion of the overall market for the foreseeable future. Moreover institutional investors argue that they cannot outbid owner-occupiers if they are to achieve the rate of return required (IPF, 2014; LSE London, 2015; IPF, 2016).

Of the new interventions, the curbing of tax relief applies to individual landlords only, while the new stamp duty will apply to individual landlords and company landlords alike.

At present only 5% of landlords appear to be operating as limited companies. The recent BDRC report provides an indication of landlords' likely response to these changes. Some 60% of landlords interviewed—and 69% of those in the higher rate tax band—said they would increase rents as a result of the tax changes, while a quarter said the policy would lead them to sell property. For landlords with larger portfolios (those with over twenty properties) the proportion was higher, with one in three saying they would divest within the next twelve months. According to the survey report,

...professional' landlords appear to be most disgruntled of all. Whilst all the indicators suggest continued strong rental growth in the sector, recent changes to legislation and compliance requirements are making landlords' operations and obligations more difficult to manage and squeezing profitability. Landlords tell us the changes will deter them from investing further in the future and in many cases they will vote with their feet by leaving the rental sector or significantly reducing their portfolios (BDRC Continental and Allsop, 2015 p. 3).

⁵See Savills (2016) for a discussion of the growth of this sector

All of this is a far cry from the government's own stance over recent years. In its 2010 review of the PRS the Treasury commented,

In the UK, small individual landlords, not institutions, dominate PRS supply. It is estimated that in England individuals or couples own 74 per cent of the PRS stock, and with over two thirds of those owning five or fewer properties. However, there have been important niche roles for larger landlords, who have tended to specialise, catering for students, the retired, or employer provided accommodation. And in many cases these portfolios have been acquired through acquisitions of existing stock, rather than investment in new-build....

The UK is not an outlier in terms of this dominant role for individual, private landlords. The picture is the same in the majority of high-income countries, although variations result from historical, policy and institutional features of rental markets in individual countries. In France, for example, a higher proportion of the rental stock is owned by individuals and couples than in the UK. In Germany individuals and couples landlords still account for over two thirds of the PRS stock. And while Germany has some examples of very large residential investment companies (e.g. Deutsch Annington owns over 200,000 properties), these holdings are predominantly the result of privatisations of previously state-owned or employer-provided accommodation (HM Treasury, 2010).

While the rhetoric may favour professional management of large portfolios it is worth noting that one survey shows over 20% of landlords use professional agents to manage at least parts of their portfolios and another 38% use agents to secure lettings (BDRC, 2016). Other surveys show the proportions to be higher.

In summary, the distinctions between amateur and professional, large and small, and institutional and individual and company landlords are largely artificial. Globally private landlordism is a 'small business' business. Even in Germany, noted for institutional investment, only 15% of the PRS is owned by institutions and the market is dominated by individual landlords (Whitehead et al, forthcoming). While there is clearly a case for bringing in institutional funding this will probably only ever support relatively small parts of the market. So 'taking sides' in the way the government seems to have done is likely to produce distortions that will not be helpful to the market in either the short or the long run.

Behaviour of landlords in a downturn

In the HM Treasury Consultation Paper on powers of direction for the Financial Policy Committee (2015a), much is made of the potential for Buy-to-Let lending to amplify housing market cycles, both in the upturn and in the downturn. It is argued that in an upturn, Buy-to-Let investors have incentives to come into the market and put upward pressure on house prices for both owner-occupiers and other landlords. This may in turn increase financial risk as borrowers take on more debt. In a downturn and with rising interest rates to which investors were particularly exposed, the argument was that Buy-to-Let investors might exit the market adding to downward pressure on prices. The recent survey carried out for the Bank by NMG Consulting is cited as giving the evidence for this.

The NMG survey has been undertaken since 2010. It covers Great Britain and is now operated as an online survey of 6007 households. In the latest results, published in December for the September 2015 survey, 342 respondents (5.6%) declared that they owned one or more Buy-to-Let properties (mainly a single property but some over four—the total number of properties covered is in excess of 600). Some 123 of the landlord respondents indicated they had an interest-only mortgage while 122 had no mortgage and 73 had a capital repayment mortgage. The age profile of these landlords was strikingly different from that shown in other surveys (see Table 2.9). While other surveys show landlords to be largely middle-aged and older, the NMG sample was roughly evenly distributed across age bands from age 16 and up, which seems implausible. By region, 19% of respondents lived in London, 11% in the SE, 8% in the SW and 11% in East Anglia, 9% were in the West Midlands, 9% in the East Midlands, 12% were in the North West, 11% in Yorkshire and 2% in the North. So roughly half were in Southern England (49%), 43% in the North plus 3% in Wales and 7% in Scotland. Again this is not replicated in other surveys.

The survey posed two questions about what the respondents might do if the current situation changed.

- (Question 1) 'Would you sell one (or more) of your buy-to-let properties if interest rates were to rise such that rental income were not enough to cover mortgage repayments and expenses?'
- (Question 2, asked of those who did not answer definitely to the first question) 'Would you sell your buy-to-let property if rental income didn't cover costs AND property prices were also expected to fall?'

Table 4.4: Would interest-rate rises cause you to sell?

| | Yes | Probably | Maybe | Don't know | Refused | Total |
|----------------|----------|-----------|----------|------------|---------|-------|
| Q1 2015 | 40 (21%) | 73 (38%) | 73 (38%) | 6 | 2 | 194 |
| Q2 2015 | 23 (15%) | 131 (80%) | 0 | 12 | 1 | 167 |

Source: BoE/NMG

There were 194 responses to Q1 (Table 4.4), with a clear majority saying that an interest-rate rise would cause them to sell-though the scale of the sell-off is unknown. With respect to the second question, 15% of those responding said they would definitely sell and 85% said probably. There were also 12 who didn't know (and 1 who refused). The FSR comments that the survey suggests that around 15% of Buy-to-Let investors would consider selling their properties if their interest payments were no longer covered by rental income. A further 45% would be inclined to sell if property prices were expected to fall by more than 10%. The Bank is using weighted data in the FSR so our results are not strictly comparable.

The survey also asks two further questions which give insight into the sample captured. These were

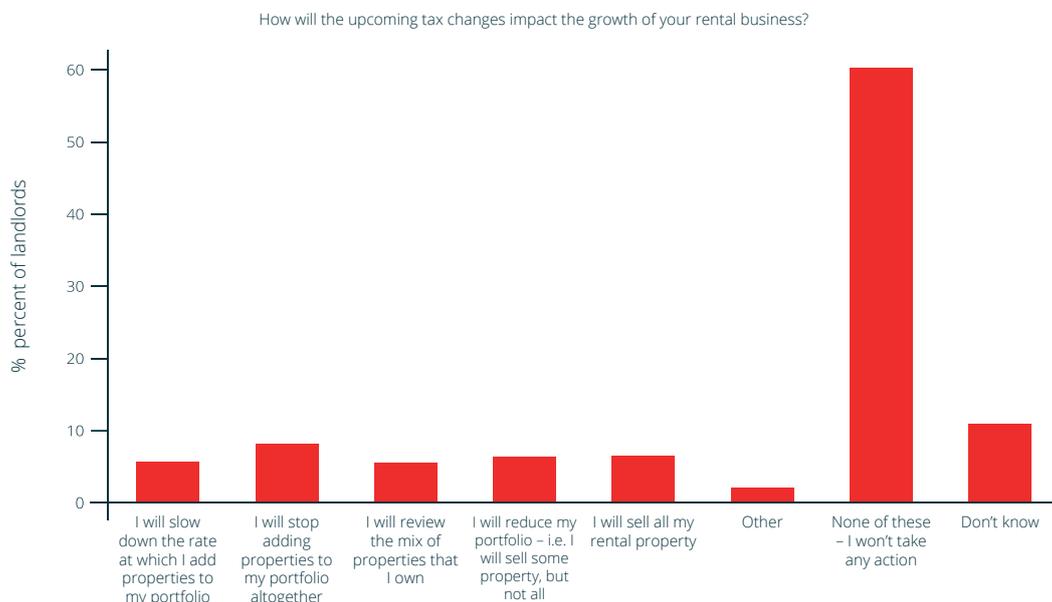
- 'Are you aware of the proposed reduction in mortgage finance tax relief for Buy-to-Let investors paying higher rate income tax announced in the Summer Budget 2015?' [146 said no (43%), 143 said yes (42%), 45 didn't know and 8 refused (total 342)] and
- 'Which of the following best describes the effect the reduction in mortgage finance tax relief will have on your Buy-to-Let investments?'
 - o Intend to increase rents (36 said no and 15 said yes);
 - o More likely to sell (31 said no and 20 said yes);
 - o Less likely to invest in additional Buy-to-Lets (36 said no and 15 said yes),
 - o Other; not planning to take any action; don't know; prefer not to state

Both these answers give a sense of the population of landlords in this sample. By a small margin there were more landlords unaware of the tax changes than aware and in terms of actions that might follow we have contradictory evidence. It certainly suggests that the picture is rather more complex than as set out by the Bank. It is clear the NMG survey coverage of the Buy-to-Let sector has its limitations, as it is a general household survey with no weightings to secure larger number of such respondents (see Chapter 2 where we discuss details of recent surveys).

The recent CML YouGov survey published on 6th January 2016 (Pannell, 2016) covered 1000 landlords. Respondents were asked how they would cope with a 1.5% rise in mortgage rates over the next three years, which was seen as a plausible scenario. The YouGov survey indicated that 75% of landlords foresaw no problems in meeting their mortgage payments and only 13% of respondents indicated they would do this by raising their rents. The survey also asked about the impact of the tax measures announced in recent months. Figure 4.1 gives the details and it suggests landlords will be able to deal with the financial impacts of these changes in a number of ways. Certainly it does not suggest that the biggest impact will be to reduce the availability of homes in the PRS. The CML suggests that these in combination with the SDLT changes 'risks having a significant indirect effect on investor sentiment, altering the direction of travel for Buy-to-Let lending and the further expansion of the PRS'.

Those landlords who expect to depend on their rental investments as a pension are unlikely to respond to changes unless they affect returns to such an extent that other long-term investments are clearly preferable. Recent developments in global stock markets may represent a buying opportunity for the brave, but also emphasise the fact that the value of stock portfolios can go down as well as up.

Figure 4.1: Likely impact of tax relief changes on portfolios



Source: CML YouGov survey of landlords

Evidence from previous downturns

The Buy-to-Let market was established in 1996, just after the 1990s recession and well before the 2007/08 crisis. A number of research assessments have been undertaken over the last 20 years that have relevance to the current debate. In 2005 Scanlon and Whitehead published a detailed study of the Buy-to-Let sector for the CML. As discussed earlier, the report distinguishes between professional and non-professional or so-called 'amateur' landlords, suggesting that professional landlords accounted for 20.5% of respondents and most of them did not work full-time - only 31% were full-time landlords (14% half-timers). Of relevance today, only 21% of these professionals conducted their business as companies or partnerships. Professional landlords tended to be younger than non-professionals - two-thirds were aged between 35 and 54, while 86% of non-professionals were over 45 and more than half were over 55. Only a tiny minority of professional landlords were of retirement age, compared to 20% of non-professionals in this group.

The report also identified those landlords who would be most vulnerable to future interest-rate rises--those with high LTVs. It showed that only 105 (7.8%) had LTVs of over 80% on their residential rental portfolio and after adjusting for double counting this reduced to 69%. In terms of future intentions, a small percentage of landlords surveyed - less than 6% - indicated they planned to reduce their portfolio or leave the market over the next 12 months. About 50% of landlords planned to keep their portfolio the same size, and 38% planned to increase it.

Scanlon and Whitehead develop this more fully in their later article on the economic rationality of landlords (Scanlon and Whitehead, 2010). They noted that while 48% of landlords said that stable or rising property prices were a reason to increase their portfolio, only 16% supported the converse, i.e., that falling or stagnating property prices were a reason to sell. They suggest that the weak response to falling property prices might reflect the significant financial hurdle represented by transactions costs for real property, and argued that very large price movements (for stocks or property) could be required to offset the transactions costs involved in making changes to portfolios of rental property (it should be noted that these costs have risen sharply since that study was undertaken). The authors conclude 'that individual private landlords do generally respond to economic stimuli in rational ways. While professional landlords are more responsive to some stimuli—particularly interest-rate changes—than non-professionals, the difference is not enormous.'

The literature suggests that landlord intentions vary over time. Crook and Kemp (1996) found that 24% of landlords planned to decrease their holdings in the following two years. Their survey was undertaken during a period of falling property prices, whereas the 2004 CML survey followed a long period of residential price rises. Crook and Kemp found that 38% of landlords planned to increase their holdings in the next 12 months. The 2001 ODPM survey of private landlords found that 21% expected to acquire more properties in the next two years, so since 2001 there had been a substantial rise in the percentage of landlords intending to expand their portfolios. We conclude that, taken together, the findings of Crook and Kemp, ODPM and CML suggest that landlords' behaviour was cyclical rather than counter-cyclical – that is, many landlords acquired property in a rising market while a minority said they would dispose of it in a falling market.

In that regard the results of the surveys undertaken in the aftermath of the 2007/8 downturn become important. Shelter with the Money Advice Trust published a detailed study of tenants and landlords in 2010, which included results from a July 2009 survey of 440 members of the National Landlords Association (who were probably concentrated at the more 'professional' end of the spectrum). This showed that 60% of landlords were managing financially during the recession without any difficulty. Just over one in ten were constantly struggling or falling behind, with one-third struggling from time to time. Overall, 48% of landlords had financial commitments outstanding on all the properties in their portfolio, with a further third having finance on some or most of their properties. Struggling landlords were more likely to have finance commitments on a larger proportion of their portfolios (56%). 49% of landlords agreed that being a landlord during the recession was stressful; one-third disagreed. Agreement with this statement was highest among struggling landlords (78%).

Seven per cent agreed with the statement 'I can't see myself being a landlord in 2010'. This reached 9% among the landlords who were struggling financially. The report suggests that if this figure were similar for non-NLA members it would imply that around 100,000 landlords doubted that they had a future in the business in 2010 (though we would note there was little to suggest an exit of this scale took place). Interestingly in contrast to the arguments put forward by Scanlon and Whitehead, 52% of respondents agreed that a recessionary environment (2009) was a really good time to grow their portfolio and they outnumbered those who disagreed by two to one. Landlords letting in the housing benefit market were most likely to agree strongly that the recession presented an opportunity for expansion.

In 2014 McCann reported on a study of modelled UK mortgage default using data from three Irish-based banks operating in the UK. This report has been cited as evidence that Buy-to-Let landlords are more likely to default than owner-occupiers. The report states;

The lending patterns of the Irish banks are not necessarily perfectly representative of activity in the UK mortgage market as a whole. ... since 2007 (the date at which CML data on lending by LTV category begins), Irish banks have systematically lent at higher LTVs than the UK market in its totality. Since 2009, the volume of lending at above an LTV of 90 has been around 2 per cent in the UK market, while the percentage of Irish banks' mortgages in this category has been between 10 and 20 per cent. The pattern presented suggests that the loan book analysed here is originated with more relaxed credit standards than the population of UK mortgages. (McCann, 2014 p. 7)

This is an important caveat given that the model predicted that Buy-to-Let mortgages would be more likely to default and less likely to cure than mortgages on owner-occupied properties. McCann said there was little evidence of 'strategic' defaults by owner-occupiers,

which is likely explained by the full recourse nature of the UK's personal bankruptcy code. The converse is true among Buy-to-Let investors, where improvements in equity, independent of changes in affordability, have a much stronger relationship with Probability of Cure. The fact that Buy-to-Let mortgages move readily out of default in response to changes in equity provides suggestive evidence that many of these defaults were "strategic" in nature.

Setting the specifics of default aside, Bracke (2015b) found that buy-to-let landlords re-sell their properties at about half the rate of owner-occupiers.

In summary, the evidence from past downturns is not as negative as the government and the Bank might argue. Clearly the past is no guide to the future but a careful exploration of this issue is an essential prerequisite to a policy intervention. The Buy-to-Let sector has displayed considerable resilience over time and though there clearly are risks most landlords seem able and willing to manage them. Indeed given their motivations for being in this market they have a good reason to do so. If and when savings rates rise and the stock market recovers, landlords will have a wider range of choices and there may be more exits. As has always been the case there will be some turnover. However, in our view, the majority will remain.

Conclusions

This chapter has sought to bring together the core housing-market arguments about the role of the Buy-to-Let (mortgage) sector and subject them to critical and evidence-based review. The stances adopted by the Government and the Bank particularly on competition between Buy-to-Let and first-time buyers and on how Buy-to-Let mortgagors might behave in a downturn do not appear to be well supported by the evidence. Policy makers and the media have chosen to ignore the substantial research literature on both the PRS and Buy-to-Let markets which has tracked developments over time and which is in the public domain, choosing instead to put forward policies that chime with macro concerns as well as popular debates and perceptions. While competition with first-time buyers clearly exists it is not universal particularly because the two sectors tend to be looking for different locational attributes. With respect to the rather negative comments from the Bank and the Government about the behaviour of landlords in downturns, the evidence suggests they have been more likely to hold than sell in earlier periods of uncertainty. In particular those who are looking to supplement their pension into the longer term will be more focussed on the longer term potential particularly with respect to rental income.

CHANGING THE LANDSCAPE FOR BUY-TO-LET?

The future of the private rented sector (PRS) will be determined not only by fiscal measures but by many other factors - particularly the promotion of home ownership (which will draw away some potential tenants) and the relative returns from other investments.

The mortgage interest tax changes announced will mostly impact private individual investors with small portfolios and Buy-to-Let loans. Those who already pay higher or additional rate tax will clearly be affected; in addition, the way the tax is calculated means some landlords will be pushed into higher tax rates and/or lose income-related benefits.

Together the changes to mortgage tax relief and Stamp Duty Land Tax (SDLT) will change the incentive structure for landlords. It is clear that some will sell a portion or all of their properties; some will reduce gearing; some will postpone or forego further investment in the sector. What is not clear is the magnitude and timing of these impacts. This will depend as much on wider market and economic conditions as on specific changes in the taxation of landlords.

Potentially on the horizon are future regulatory changes, including increased controls on Buy-to-Let lending and control of rent increases, at least in some cities. Of more immediate import is the cap on Local Housing Allowance (27% of private tenants claim LHA) and new measures that will reduce the supply of social housing in the short term.

Efforts to encourage institutional investment are bearing fruit but even if it grew rapidly, the segment would make up only a small portion of the PRS.

Government initiatives to facilitate owner-occupation together might add up to 100,000 units per annum to the stock. Not all will be genuinely 'additional', as some of the households who benefit would have bought anyway, but even so the marginal demand for rented property will fall. Taken together the various measures, together with wider economic and demographic trends, can be expected to slow the rate of growth of the PRS but not to reverse the upward trend.

Many commentators seem to assume that growth in the PRS is almost inevitable, just as they used to assume that growth in owner-occupation was inevitable. In reality there are a number of drivers, both policy and economic, that could change significantly and modify the terms and conditions within the sector. Equally, changes affecting the other main tenures could affect tenure choice for investors and consumers.

At least four areas of potential policy change could impact on the incentives and risks faced by private landlords and the opportunities available to potential tenants. There are also more fundamental issues around the operation of the housing market and the wider economy that could influence the appetite of investors and households to be in the private rented sector.

The areas of policy most likely to affect the sector include:

1. The taxation of Buy-to-Let landlords compared to other purchasers/owners and rental property compared to other investments and assets;
2. Regulatory change particularly with respect to rents and security, but also mortgage market controls whether directly by the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) or on the direction of the Financial Policy Committee (FPC) as well as via the capital requirements regime through the Bank for International Settlements Basel Committee;

3. The role of institutional investors especially in the new build market;
4. The availability of social rented housing and local housing allowance;
5. Initiatives to support owner-occupation.

In terms of the housing market and the more general economic environment the major issues are around house prices, inflation, interest rates and currency fluctuations as well as the prospects for international in-migration.

The impacts of taxation changes

This is the area of most immediate concern because of the initiatives included in the Budget and Autumn Statement in 2015.

First, the government is introducing new Stamp Duty Land Tax (SDLT) on dwellings that are not principal residences from 1st April 2016. As announced in the March 2016 Budget this will now include all private landlords.

Second, in future private individual landlords will be unable to deduct all of their finance costs from their property income to arrive at their property profits. They will instead receive a basic-rate reduction from their income tax liability for their finance costs. This will be phased in as follows:

- in the 2017/18 tax year the deduction from property income (as currently allowed) will be restricted to 75% of finance costs, with the remaining 25% taken as a basic rate tax reduction
- in 2018/19, 50% finance-cost deduction and 50% basic rate tax reduction
- in 2019/20, 25% finance-costs deduction and 75% basic rate tax reduction
- from 2020/21, all financing costs incurred by a landlord will be offset by basic rate tax reduction only.

These changes will not apply to corporate landlords but their impact on individual landlords will be considerable. The reduced allowances mean individual landlords will have higher taxable incomes from their properties, will pay more tax and potentially receive fewer benefits. Some landlords will change tax bands as a consequence of the way the calculations are made, thus becoming subject to higher rates of tax. The Treasury has forecast the additional tax take as £215 million in 2018/19 rising to £665 million in 2020/21, and says one in five individual landlords will be affected.

Third, the government is reforming the wear and tear allowance. Landlords renting furnished accommodation currently can deduct 10% of their rental income to cover wear and tear. From April 2016, the government will replace this with a new relief that is based on the actual costs of replacing furnishings. The estimated impact of this measure is around £150-£250m per annum in the period up to 2020/21⁶.

Full evaluation of the impact of these changes is difficult especially given we have little information on the tax status of landlords. The IFS recently published an assessment of the effective tax rate (ETR) generated by the changes to mortgage interest deductibility (Adam and Shaw, 2016). For landlords who were and will remain basic-rate taxpayers there is little change. However the ETR for higher-rate tax payers will increase from 47% to 76% for properties that are 50% funded with a mortgage. However, the authors go on to note,

Under the new regime, mortgage interest will reduce income tax liability directly rather than via a reduction in taxable income. This has important implications. Landlords whose taxable income is currently kept below the higher-rate threshold by mortgage interest deductions will find that, while receiving a tax credit, they can no longer deduct the mortgage interest from their taxable income and are therefore liable for higher-rate tax. The reform will thus push many landlords into higher-rate tax – and, more generally, into higher tax brackets.

(Adam and Shaw, 2016 p. 55)

⁶In addition in the March 2016 budget the Chancellor introduced a lower capital gains rate for all investments other than those in residential property.

⁷See <http://www.landlords.org.uk/news-campaigns/news/incorporating-%E2%80%98doesnt-%E2%80%99t-stack-up%E2%80%99-majority-landlords>

The IFS argues that the impact on savings incentives for some landlords will be very considerable. For certain individuals ETRs will be as high as 117% as a consequence of the loss of personal allowances/child benefit/tax credits triggered by the increase in taxable income. As the IFS notes 'As a result, the effective tax rate on mortgage-financed investment in rental property increases far more for those facing withdrawal of these kinds than for other higher-rate taxpayers'.

The IFS is very clear that home ownership is treated far more generously in tax terms than renting and that these reforms have added to that, saying 'rental housing looks set to become easily the most tax-disadvantaged of the major asset classes we consider in this report'. While landlords can avoid some of this by becoming companies, this would make them liable for corporation tax, dividend tax and CGT equivalent to that for higher rate taxpayers, so the decision (to switch) is a complex one.

The NLA's view, based on surveys of their members, is that the tax changes will affect over 200,000 landlords with Buy-to-Let mortgages, who will lose post-tax income in excess of £858 million per year from 2020⁷ (assuming typical house prices, gearing and interest rates). This equates to a loss for each landlord of around £840 per year or 8 per cent of the national average annual rent in the PRS.

In a recent NLA survey 26 per cent of respondents indicated they would have to sell some properties and 5 per cent planned to exit the sector completely. If this were to occur nationally it would reduce the PRS by some 615,000 units of accommodation. Around 58 per cent of those who would be affected by the change and planned to stay in the market said they would need to increase rents, and a further 14 per cent refused to rule it out.

An analysis by tax experts at Paragon Group provides more detail. Calculations based on the notional example of a medium-g geared property (60% LTV) and a landlord with salary income of £50,000 (Table 5.1) show that after the transition period the effective tax rate rises from 40% to 56.8% - an increase of 42%. Table 5.2 provides calculations for portfolios of different sizes and a landlord on a salary of £28,000. The increases in effective tax rates are due only partly to the reduction in mortgage interest deductibility; more importantly, the way the tax new calculations are performed will take some landlords into higher tax brackets and affect eligibility for other income-related allowances such as Child Benefit.

Table 5.1: Illustrative effects of proposed tax changes

Assumptions: medium-g geared landlord, salary of £50,000

| | Current position | Position after tax changes |
|--------------------------------------|-------------------------|-----------------------------------|
| | £ / annum | £ |
| Salary | 50,000 | 50,000 |
| Rental profits | 6,600 | 12,000 |
| Statutory total income (STI) | 56,660 | 62,000 |
| Personal allowance | (10,600) | (10,600) |
| Taxable income | 46,060 | 51,400 |
| Tax at 20% | 6,357 | 6,357 |
| Tax at 40% | 5,686 | 7,846 |
| Credit for interest | | (1,080) |
| Tax liability | 12,043 | 13,123 |
| Marginal tax on rental income | 2,640 | 3,720 |
| Effective tax rate | 40% | 56.8% |

Source: Paragon analysis

Table 5.2: Illustrative effects of proposed tax changes by portfolio size

Assumptions: medium-g geared landlord with two children and £28,000 salary

| | Number of properties | | | |
|--------------------------------------|----------------------|----------|----------|----------|
| | 1 | 2 | 3 | 4 |
| Salary | 28,000 | 28,000 | 28,000 | 28,000 |
| Rental profits | 12,000 | 24,000 | 36,000 | 84,000 |
| Statutory total income (STI) | 40,000 | 52,000 | 64,000 | 112,000 |
| Personal allowance | (10,600) | (10,600) | (10,600) | (10,600) |
| Taxable income | 29,400 | 41,400 | 52,400 | 107,400 |
| Tax at 20% | 5,880 | 6,357 | 6,357 | 6,357 |
| Tax at 40% | | 3,846 | 8,646 | 30,246 |
| Reduction in Child Benefit | | 364 | 1,823 | 1,823 |
| Credit for interest | (1,080) | (2,160) | (3,240) | (7,560) |
| Tax liability | 4,800 | 8,407 | 13,586 | 30,866 |
| Marginal tax on rental income | 1,320 | 4,927 | 10,106 | 27,386 |
| Effective tax rate | 20% | 37.3% | 51% | 59.3% |

Source: Paragon analysis

More-highly-g geared landlords will be most affected, so in time we can expect to see the level of gearing reduce. At the same time the government is proposing changes to pensions which will make investing in them less attractive, which raises the question of whether equity-financed Buy-to-Let might be a better option. Along with product development to facilitate the rapid repayment of loans we are likely to see more corporate structures and possibly more collective investment schemes such as residential REITs.

It can also be argued that the changes deepen the tax disadvantages landlords face in comparison to home owners, who do not pay capital gains tax on their principal home. However, this is not a position all would agree with. For instance, Generation Rent has argued that private landlords receive more than £26bn plus of support and relief, made up of £9.3bn of housing benefit paid on behalf of low-income tenants via local housing allowances (LHA), £1.69bn through the 'wear-and-tear' allowance, £6.63bn of tax that landlords do not have to pay on mortgage interest payments and £9.06bn of tax landlords do not pay on their annual average capital gains (Guardian, 9/2/2015).

This presents a rather biased view of what constitutes support (e.g. landlords pay capital gains tax when their investments are realised, and interest tax relief and wear and tear are normal costs of investment). It is the case that the LHA supports rents in the private rented sector especially in the lower end the market and probably accounts for some 5% of overall rental income. Bentley (2015) has also highlighted the rising benefit costs and asks whether a better deal can be done.

Overall, HM Treasury estimates that restricting the mortgage interest tax deduction to the basic rate will raise £665 million in its first full year of implementation in 2020-21. The 3% Stamp Duty surcharge is expected to raise £625 million in 2016-17, mostly paid by landlords. In addition a reduced window for payment of capital gains on residential property is expected to bring in £230 million in 2020-21 and the reform of the wear and tear allowance is expected to raise £205 million in its first year, 2017-18. Adding together these measures, the exchequer will receive additional revenues of about £1.7 billion a year (HM Treasury, 2015b).

⁹The government has announced that there will be no exemption for large landlords, as had been expected.

The most recent BDRC survey indicates that one in five landlords will sell or put off buying homes, with 75% of these attributing this to the July announcements. The SDLT proposals are seen as having a particularly significant impact on larger landlords (20 homes or more) though much depends on the final structure of the scheme⁸. Clearly some landlords could incorporate themselves into companies and many will choose to do so. However, based on this survey the NLA have argued that up to 500,000 homes might be sold in 2016/17 as a consequence of the measures and 100,000 per annum in each subsequent year to 2021. Overall, though, the NLA says that the PRS will shrink by 136,000 homes, a relatively small proportion of the total.

In a recent evaluation, the Intermediary Mortgage Lenders Association (2016) suggested that the additional income tax burden on landlords of around £870 million (from the restriction of the mortgage interest deduction and the end of the wear and tear allowance) is equivalent to 1.8% of the £50 billion estimated revenues of the PRS as a whole. IMLA argued this was unlikely on its own to seriously dent landlord ambitions at a time when tenant demand and rents were rising, although some highly leveraged landlords would face much higher tax bills. Averaged over the life of a typical buy-to-let investment (which the Association of Residential Letting Agent's landlord survey estimates to be 20 years) the 3% stamp duty surcharge costs a modest 0.15% a year, and may not be applied to landlords with larger portfolios. While this is a fairly sanguine view of the aggregate effect, the impacts on certain individuals will be significant and the policies will introduce important distortions. Perhaps most importantly they will shake confidence (indeed, have already done so) and change the incentives for new entrants to come into the market.

Regulatory change

New rules around Buy-to-Let mortgages took effect in March and more may be imposed. Regulators are particularly concerned about the prevalence of interest-only mortgages in the sector, especially if there is house price volatility. So-called 'consumer Buy-to-Let' is now regulated via the Mortgage Credit Directive from March 21st 2016. Not all lenders will offer consumer Buy-to-Let, but any additional constraints on total lending volumes will be relatively minor. More serious are the likely powers of direction to be granted to the Financial Policy Committee who can then impose requirements on lenders in this sector via the FCA and the PRA. These are likely to include proposals around a minimum interest coverage ratio (ICR) and a forward assessment of affordability. The fact that the PRA is now consulting on underwriting standards for Buy-to-Let is no coincidence (PRA, 2016). The consultation paper explores an ICR requirement of 125% at 5.5%, more robust approaches to assessing landlord costs and the impact of tax on rental income as well as the use of a test of future affordability referenced to market rates and an additional 2% stressed rate.

The proposals from the Basel Committee on Banking Supervision (2015) to rework the standardised approach to credit risk are much more serious (plus resetting the floors for lenders using the internal ratings based approach - and not only for the Buy-to-Let sector), but they are still only proposals and implementation would be some years away. However, all of this gives a sense of the prevailing mood and point to a general tightening of regulation around revenue-producing real estate. In the short term landlords will be more affected by the economic environment, particularly interest rates and house prices, as well as taxation (all of which impact on expected total returns) but over the longer term these new requirements could be significant.

With regard to rents and security of tenure, across Europe there is discussion of imposing or tightening rent stabilisation, and additional constraints on rent increases have been put in place in Ireland, France, Germany and the Netherlands, and legislation is under consideration in the Scottish parliament that will enable local authorities to limit rent increases in high-demand areas (Whitehead et al, 2016 forthcoming). In the English context most of the emphasis has been on enabling longer term tenancies within the AST framework and working with mortgage lenders to take out restrictions. Only in London is there any significant debate about rent stabilisation. The London Assembly's latest report suggests that 'a new default rental contract of three years, with initial rents set by the market, and increases limited to the consumer price index' should be put in place as standard' (GLA, 2016, p. 7), while a number of mayoral candidates have made suggestions about how to make private renting more affordable in the capital (Inside Housing, 2 October 2014 and 2 March 2016). These are relatively landlord-friendly proposals but could affect landlords with mortgage restrictions and would limit their capacity to respond to changes in cost and demand. The Scottish changes are not yet law so no conclusions can be drawn, although the NLA, other landlord bodies and institutional investors have raised concerns.

Institutional investment

A report by DTZ last year suggested that the PRS is now worth an estimated £839 billion. They estimated that institutional investors accounted for just 2% of this total with private landlords continuing to dominate the market (DTZ, 2015). More evidence of the scale of institutional investment comes from the Investment Property Forum, which recently surveyed respondents holding or managing over £3 trillion of investments. Of this, real estate comprised approximately £220 billion (about 7.32% of all assets). Almost four-fifths of respondents (37 out of 48) had exposure to residential assets in their UK portfolios. Around 80% preferred direct ownership, and their holdings made up about 66% of residential assets in the sample, but investment in development was also attracting some. The main attractions of residential property were seen to be its returns profile and its development potential. The Investment Property Forum estimated potential new investment at close to £6.5 billion, subject to the availability of suitable stock across all types of residential assets (IPF, 2015).

These two assessments point to the relatively limited role currently played by institutional investors, and their strong preference for purpose-built rental stock. The government's commercial Build to Rent loan programme is only now getting underway, with fewer than ten completed developments and perhaps ten times as many with planning permission. Into the medium term maybe 10,000 units a year might be added through this initiative. Separately, housing associations are developing new market-rent accommodation with the support of institutional equity (see below). While these investments are clearly valuable, the level of output means they should be regarded as a small complement to Buy-to-Let at least over the next decade.

Social housing and the Local Housing Allowance

Government has indicated that social housing providers will no longer receive direct public grant. Housing associations will have to fund new social and affordable housing through cross-subsidy from reserves and market-sector activity as well as s106 (to the extent that this remains viable after the Starter Homes element is provided). With the support of institutional investors, some associations are looking to provide market-rented housing as part of mixed-tenure developments. More generally, housing associations intend to increase output overall in the next few years (House of Lords Economic Affairs Committee, 2016), but expect to provide a lower proportion of units as social housing with the majority being for full or partial sale to home owners. Many are also keen to get involved with private rental on the management side.

The Housing and Planning Bill currently making its way through Parliament, together with the adoption by housing associations of the Voluntary Right to Buy, will affect the operation of social housing into the future. The main uncertainties are with respect to the existing social housing stock and the replacement of that stock. The Voluntary Right to Buy Agreement, under which housing association tenants will get the right to buy their units on the same terms as local-authority tenants, calls for 1:1 replacement (the aspiration is for this to be 2:1 in London, reflecting higher value centrally located homes being replaced by cheaper less well located homes in cheaper areas) although not always in the same locations or the same tenure. Access for lower-income households into social housing is likely to decline significantly, especially in London. This tendency will be reinforced by the loss of council stock, as local authorities will be required to consider selling high-value units when they become empty (and will have to remit payment to government as if they had done so). The highest value units are in central areas, while any replacements will be mainly concentrated in outer areas. So while in the medium term at least some units will be replaced, overall the changes will leave more households dependent on the private rented sector.

What happens to the social housing sector affects the PRS in several ways. The two markets overlap, and via the Right to Buy many formerly social homes have found their way into the PRS. Given resale restrictions it will be some years before Voluntary Right to Buy properties transfer to the PRS, and the stock profile will differ from earlier Right to Buy sales. There will also be an increase in Right to Buy among council tenants, though again the units will not enter the PRS for some years.

Private landlords are perhaps most concerned about the future of Local Housing Allowance (LHA). The summer 2015 budget introduced a four-year freeze on LHA and this together with other welfare constraints will make it more difficult for those on benefit to pay any increases in market rents. This is likely to lead to some stickiness in rents as 27% of private tenants receive at least some help and maybe 10% more are eligible for assistance. While most Buy-to-Let landlords say they do not let to housing benefit tenants, the reality is that few would evict a tenant simply because they became eligible for the LHA due to a drop in income.

Government initiatives to promote owner-occupation

A suite of recent policies demonstrates the government's strong support for owner-occupation. Higher-income social tenants are being helped to change tenure through Right to Buy; Help to Buy has been continued to at least until 2020, and the rate in London extended to 40%; and the Starter Homes initiative will in many areas take the top slice of affordable housing provision from Section 106 agreements.

There have been some offsetting changes with respect to mortgages, including the removal of the mortgage guarantee from 2016 (on the basis that the market for high loan-to-value loans has recovered) and the limit on the proportion of new loans at over 4.5 times income. Additionally the government are consulting on whether the Financial Policy Committee should have power of direction over loan-to-value and loan-to-income limits if macro-stability conditions required. These would reinforce underwriting standards and might exclude some marginal purchasers or slow turnover in the market for existing homes.

The proportion of new-build units that could be included within government-sponsored owner-occupation schemes could be high:

- 25,000 per annum could be covered by Help to Buy and its extension;
- developers can be expected to build 30 - 40,000 Starter Homes per annum, if current teething problems can be overcome;
- there is a commitment to 135,000 shared ownership homes over this Parliament (though this will in part overlap with the mainstream Starter Homes programme); and
- there will be a shift to shared ownership within S106 affordable housing allocations.

These government initiatives could produce up to 100,000 new owner-occupation units per year, though much would not be genuinely additional because beneficiaries would include those who would have bought anyway. Such a large programme of supported home ownership could be expected to increase the number of first-time buyers entering the market. It might be enough to stop the decline in owner-occupation in proportional as well as absolute terms and thus to slow the growth of private renting.

The overall impact on tenure mix depends on whether there is a continuing flow from the social rented sector and whether existing (often ex-council) housing continues to transfer to the PRS, as well as the extent to which new build goes directly into the PRS. It is almost certain that the rate of growth of the PRS will slow, but it is unlikely that the changes would be enough to reverse the growth unless the economy, incomes and confidence picked up very significantly to allow unsubsidised home ownership to expand more rapidly.

Wider economic change

The drivers of change in the PRS are ultimately about fundamentals. For investors, these are rental and total returns in the sector compared to returns on other investment opportunities. For tenants, these are the costs of private rented housing compared to other tenures (including taxation and subsidy along with access to credit and other housing opportunities) (Whitehead et al, forthcoming).

The major factors likely to affect the demand for private renting over the next few years include:

- (a) the net flow of migrants into the UK – if this fell significantly then demand for private renting would also fall, as those who have been in the UK for some time move into other tenures;
- (b) the state of the economy including rates of employment and unemployment and especially the extent of real income growth and its impact on confidence. Economic uncertainties normally increase the length of time that people remain in the PRS;
- (c) the rate of increase in house prices and its relationship to increases in real incomes. These both impact on the affordability of home ownership and most directly on the numbers of first-time buyers; and
- (d) exchange rates, which affect incentives for international buyers to enter and stay in the UK housing market, including as private landlords.

Overall, there is probably significant pent-up demand for owner-occupation from potential buyers affected by affordability and credit constraints. Were the economy to grow more quickly than in the past, in many parts of the country these constraints might be better overcome. On the other hand in areas of housing pressure, especially London, the impact could be more on house prices.

Major external shocks to the economy and confidence in that economy could cause some investors to pull out of the market, as could changes in regulation and taxation. However, the general pressures would seem to be towards slower but continued growth of the sector.

Conclusions

The proposed new tax treatments will clearly damage landlords' returns and confidence and create disincentives. However, they are unlikely to be terminal. As the Intermediary Mortgage Lenders Association (IMLA) recently commented (2016);

We do not expect the tax increases aimed at buy-to-let investors to reverse the growth of the private rented sector (PRS) or the buy-to-let mortgage market, although they could slow the rate of growth of buy-to-let house purchase lending. The restriction on mortgage interest tax deductibility can be avoided through the use of a limited company and for long term property investors the stamp duty surcharge of 3% is small once amortised over the full investment horizon. We estimate that the new taxes on landlords' incomes (restriction of mortgage interest deduction and loss of wear and tear allowance) represent a 1.8% rise in taxes on landlords' aggregate estimated rents of around £50 billion. The PRS will remain the pressure valve that accommodates most of the increase in population expected over the next few years as landlords continue to respond to rising tenant demand. (IMLA, 2016 p.3)

We have not covered the more general macro-stabilisation economic arguments about borrowing levels and the stability of finance markets. These form part of the wider debate around management of demand and liquidity. Macro-stabilisation can take precedence over housing market impacts in certain circumstances – but understanding how the housing market may function if curbs are put in place should still be an important part of any such assessment.

The various current or proposed initiatives around private renting and the other major tenures will certainly influence landlord and tenant decisions, and shift incentives. However, they are unlikely to lead to net exit from the Buy-to-Let market in the short to medium term. The growth of landlordism which the government now wishes to curb is, significantly, a product of the low returns available to investors elsewhere in the market. The measures taken after the Global Financial Crisis to stabilise the UK economy (e.g., Funding for Lending) resulted in an era of low savings rates and declining pension returns and opportunities. This in turn has made it relatively beneficial for households to turn to property investment as a source of income and capital gains (Lord et al, 2013). Some 77% of landlords in the BDRC survey were using property as a pension strategy, an entirely rational and fair response to the conditions that have been created. Overall therefore unless policies are introduced either to expand the availability of other forms of investment on similar terms or significantly to worsen the returns to Buy-to-Let in current economic conditions it is likely that the sector will continue to grow.

WHERE ARE WE GOING? RENTING, OWNING AND POLICY

Will private renting continue to grow at a similar pace to the last 20 years? This depends not only on the effects of fiscal measures but on developments in other tenures and in wider investment markets.

Private individuals are and will continue to be the bulk of landlords, even if institutions massively increase their involvement. Their example, coupled with larger individual portfolios and tenant demand, will probably increase professionalism generally. The government's determined efforts to boost owner-occupation will shift some households from renting to becoming first-time buyers. This will reduce but probably not eliminate growth in demand, which also comes from job movers, migrants, young people and low-income households who cannot access social housing. Demographic pressures, the country's persistent shortfall of new homes and the probable loss of social housing will continue to underpin demand for private rented housing.

Various expert reports have forecast continued strong growth in the private rented sector (PRS), although the numbers depend on the assumptions used—and government policy announcements can invalidate assumptions from one day to the next. Our view is that government efforts to boost home ownership will be successful at least to some extent especially if real incomes rise consistently, but that neither the proportion nor the absolute quantum of private rented housing will fall. Taken together the scenarios would suggest a PRS in the range 20% and 22% within this parliament and perhaps 25% as the longer term equilibrium level. These are significant increases especially in absolute terms, even though they are lower than many other projections. They reflect current government policy and an assumption that the economy continues to improve. If the outlook is more negative, the proportion in private renting will be higher. But if real household incomes rise more rapidly the proportion in owner occupation could be higher.

The PRS plays an important role in the housing system. For many households it offers the best option for short- to medium-term accommodation; for some it is a good long-term option. Trying to shrink the sector is unwise given what we know about unmet demand and need.

Looking forward we must ask whether the apparently relentless growth of private renting can continue, given that changes in policy and the economic environment will modify both output and tenure decisions. In this chapter we clarify some of the implications arising from the earlier analysis to give some indication of the longer term position of both private renting and Buy-to-Let within that sector.

Renting

The starting point is that Buy-to-Let mortgagors are a significant part of the private-individual and small-business element of the private rented sector (PRS); that the Buy-to-Let subsector is the most active part of the market (i.e., where properties are being bought and sold); and that individual portfolios have probably expanded over the last few years, so the proportion consisting of more than one property or indeed more than a few has almost certainly grown.

Secondly, while any increase in investment by institutions is to be welcomed and there is evidence of increasing appetite, even on the most optimistic outlook their activity will not be enough to make significant inroads into the individual-owner segment. Reductions in total returns would hit all segments but would almost certainly affect institutional investors more, since the objectives of private individual landlords are more diverse.



Government is keen to encourage professional management. Institutional investors do not have the skills in-house and are worried about reputational risk; they often employ specialist management organisations that can provide high-end services. But as individual landlords' portfolios grow they may increasingly turn to professional managers who can match the additional services offered by corporate landlords. Portfolio size may therefore be just as important as ownership in determining the level of professionalization in the sector. It seems likely that the quality and range of services will continue to improve across much of the sector even though institutional investors will constitute a relatively small part of the market and, at least in the short to medium term, will complement rather than compete with individual investors.

In Chapter 5 we argued that we can expect to see a slowdown in growth of the sector as a result of tax changes and because of the government's emphasis on home ownership. The industry is currently very concerned about the impact of the tax measures, particularly on higher-rate tax payers and those who would be moved into higher rates. However, experience shows that actual outcomes often differ from those expected. Landlords' long-term decisions will depend on the opportunities available for property purchase or sale (e.g., to owner-occupiers or possibly institutional investors) and, crucially, on the returns available elsewhere. Returns on alternative investments do not seem to be greatly expanding at the present time, so the number of landlords selling all or part of their portfolios will probably turn out to be fewer than they themselves expect in the surveys quoted above—although inevitably there will be some adjustment. The PRS has seen rapid growth over the last few years together with significant levels of normal turnover. Policy direction suggests that government would like to see a slowdown, and that is the most likely outcome. Absolute decline seems much less likely.

Private renting and home ownership

The discussion about the Buy-to-Let market and the PRS as a whole is often conducted as if these were entirely separate from, and competing with, the owner-occupied market. It is easy to forget that there are important flows between them. Data from the English Housing Survey 2012-2013 show that in that year 153,000 households left home ownership to move into private renting, while 152,000 moved the other way. The PRS provides an essential easily accessed market for households that need to move. With a much diminished social housing sector, the PRS is usually the only option for owner households who move, if they are unable or unwilling to buy at that point in time. The PRS is also the first destination for most new households, and with more households being formed it clearly has a crucial role in the housing system (see also Savills, 2016a).

Equally important is the fact that the UK is still in recovery from the global economic downturn and a number of special measures are still in place, including very low interest rates; the international context in both economic and political terms is very unsettled; and the housing market in particular is out of kilter. It is therefore difficult to predict the future with much certainty. A fundamental that we do know is that UK demographic pressures are building with population growth, increased longevity and more international in-migration. In addition if the economy strengthens, income growth will add to these pressures resulting in rising demand for homes. Overall, housing supply is edging up, but the UK is still a long way from producing the roughly 250,000 homes a year it needs. One obvious impact is that as demand outstrips supply house prices will rise, affecting both access to owner-occupation and the total return on private rental investment.

Several recent studies have forecast likely tenure developments over the next decade, but most are straight-line projections that rely heavily on past trends. In its UK Economic Outlook published in November 2015, PWC argued that the expansion of the PRS would continue with an additional 1.8 million households in private rental by 2025. This would take the number of households in the PRS to 7.2 million – almost one in four of the UK total. PWC noted that the trend was particularly strong in the 20-39 age group, where more than half would be renting privately by 2025. As noted already, the number of households who own their home with a mortgage fell from around 10 million in 2001 to around 8 million in 2014. PWC project a further decline to 7.2 million by 2025 as limited housing supply, affordability and mortgage availability make it harder for first-time buyers to get on the housing ladder.

Savills, in its recent Residential Property Focus issue on 'Valuing Britain' (2016), notes that English Housing Survey (EHS) figures show PRS growth of 260,000 households per annum in recent years. The report argues that even if the government delivers its target of 400,000 new 'affordable homes for sale' over five years this would only amount to 80,000 per annum. Savills projects on this basis that about 220,000 new households per year will be looking to rent privately. In another report (Rental Britain, 2016) they say government measures will enable some households to enter home ownership but that nevertheless the PRS will grow by over 1 million to 2021. The Joseph Rowntree Foundation, in a 2014 study, argued that the PRS would house 20.5% of the population by 2040 with the social sector shrinking to accommodate around 11% (Stephens, M et al, 2014). Home ownership was expected to decline from 2020. This forecast has already been overtaken by events with private renting growing more quickly and home ownership falling rather more rapidly than expected – but also with government increasing the emphasis on home ownership. Most of these studies are fairly short term and take underlying trends as given and do little to take account of dynamics – but they all point in the same direction.

The question is how the overall market will look in a decade or so. The consensus view is that though policy changes will slow the increase in the PRS they are unlikely to reverse it; this is supported by estimates of impact in terms of sales and abandoned expansion plans. Similarly, though the decade-long decline in home ownership has slowed and there have been improvements in the numbers of first-time buyers and in the overall condition of the housing market, transactions remain low, supply is still well below market requirements and mortgage supply is now permanently constrained.

The government made much of the recent EHS survey data: a DCLG press release issued on 16 February was headlined 'We are turning around the housing market'. Housing minister Brandon Lewis MP was quoted as saying the figures showed the decade-long decline in home ownership had 'been turned around with more than 14 million owner-occupiers in the country last year'. On closer examination, especially in relation to mortgaged buyers, the picture is less clear cut. In particular 56% of those aged 24 to 34 had mortgages in 2003/04 but this had fallen to 34% by 2013/14. There was an even stronger percentage decline in the youngest cohort, although the numbers are much smaller. This suggests there has been an 'emptying out' of home ownership, especially at younger age levels, which may pull home ownership levels down as these cohorts age.

In this context, an IFS study, covering the period 1967-2007, suggested that birth cohorts with different ownership rates at age 30 typically catch up (at least to 80% of the rate of preceding cohorts) by the age of 40 (Bottazi et al, 2012). However, more recent work by the CML (2015), which builds on analyses by Alan Holmans, indicates that the rate of home ownership by age cohort has been declining and that while previous cohorts have caught up, there are grounds for believing that current cohorts might not. In particular it shows that while 71% of those born in 1960 and 1970 were home owners by the age of 40, only 47% of those born in 1990 can expect to be in the same position at that age. The CML put forward some plausible pathways, shown in table 6.2, which suggest that current younger age groups are likely not to be able to catch up. CML notes that none of this is cast in stone, and with a strong economic recovery and more initiatives aimed at boosting home ownership rates we could see some reversal of these trends. But declining access to owner-occupation does mean more adult children are returning to live at home with their parents (the figure was up an estimated 800,000 over the period 1996-2015 (ONS, 2015), and more demand for renting.

Table 6.2: Plausible home ownership paths

| Born in | Current age | Past / future age | | | | | | | | | |
|----------------------------|-------------|-------------------|----|----|----|----|----|----|----|----|----|
| | | 20 | 25 | 30 | 35 | 40 | 45 | 50 | 55 | 60 | 65 |
| % by age, by year of birth | | | | | | | | | | | |
| 1960 | 55 | 2 | 27 | 53 | 63 | 71 | 77 | 79 | 80 | 80 | 80 |
| 1970 | 45 | 2 | 21 | 50 | 65 | 71 | 73 | 75 | 76 | 77 | |
| 1980 | 35 | 1 | 15 | 35 | 44 | 51 | 55 | 57 | | | |
| 1990 | 25 | 0 | 8 | 26 | 39 | 47 | | | | | |

Source: CML 2015

As Halifax (2016) pointed out in its latest Generation Rent report, there is now some evidence to suggest younger households opting out of home ownership (reflecting choice as well as constraint). Indeed for younger generations renting privately might well become the norm, with many becoming home owners later in their adult lives, a pattern much closer to some of our European partners.

Another new phenomenon is let to buy where those already in owner-occupation rent out and re-mortgage the family home in order to enable the household to move up the housing ladder. The result is that more households own two or more homes while a higher proportion of households are unable, and maybe unwilling, to purchase. More broadly many owner-occupiers who wish to move may simply hold on to the existing home and let out the property.

All of these factors suggest that, even if the economy and the housing market improve, there are likely to be continuing constraints on entry into the owner-occupied market, especially where family assistance is not available. There are reasons to expect some expansion nonetheless and not least because of government policy, and because in many parts of the country affordability has increased. If real incomes started to rise significantly that expansion could be more rapid than currently expected. On the other hand there are diverse reasons why those who have equity may decide to maintain or increase their involvement in property not so much, as in the past, by upgrading their owner-occupied home but by adding to their portfolio. These pressures are likely to remain strong unless alternative investment opportunities improve.

Private renting and social renting

The other side of the story is the extent to which private renting is set to take on parts of the role of social renting if the stock of rented housing continues to decline, even were there to be full replacement of sales through Right to Buy and the sale of high valued homes.

There are large financial reserves both within the housing association and particularly the local authority sectors, so it is not impossible for the sector to continue to expand, but other pressures suggest that the use of these reserves is constrained by the extent of subsidy required. The pressures on developing housing associations and even local authorities are currently to take a larger role in the provision of homes for sale and market rent partly to enable them to cross-subsidise social housing and partly to take a positive role in providing and managing across the market. Other pressures on housing associations are resulting in large scale mergers and acquisitions and with that scale the potential to take on a wider range of activities. Equally there are initiatives to support the private provision of subsidised housing notably for employees but also more generally as a contribution to community. Thus what we are likely to see is the two sectors growing closer together especially in terms of providing for lower income working households.

One outcome of these trends could be better management of that part of the privately rented stock that accommodates lower income households; another is that better off social tenants will transfer into at least partial owner-occupation; a third is that there will be greater emphasis on place making and mixed communities with a range of tenures available.

Conclusions

While there are reasons to expect owner-occupation to grow at least among mature traditional households it is highly unlikely that younger households will enter owner-occupation to the extent that they did during the last four decades. This type of model could imply that the proportion of owner-occupation in England could grow to maybe between 64% and 66% over the next few years and stabilise at around that level. Equally social housing might under some, perhaps unlikely, circumstances remain at roughly current levels as housing associations respond to the challenge to expand without direct subsidy. However, it is far more likely to decline, especially if partial ownership starts to take a larger role in affordable housing provision. A guesstimate might be that it would fall over the next few years to below 15%. Over time, unless there is a policy reversal it could decline further to as little as 10% of the total stock. This would suggest a PRS in the range 20% and 22% within this Parliament and perhaps 25% as the longer term equilibrium level. These are lower levels than in many other projections, reflecting current government policy and an assumption that the economy continues to improve. If the outlook is more negative, the proportion in private renting will be higher. But if real household incomes rise significantly the proportion in owner-occupation could be higher, more in line with mature Northern European markets that still favour that sector. If so, younger households will rent but the vast majority of stable working households will be owner-occupiers.

In summary, private renting plays and will continue to play a key role in the UK's housing system. It keeps pressure off the home ownership sector by offering households a clear alternative whether for the short or long term. And even if institutional investors enter the market enthusiastically, individual landlords will remain dominant – as they are across Europe. Shrinking the sector therefore does not seem a sensible way forward given what we know about unmet demand and need. In an ideal world we could identify the goals of policy changes, establish a baseline and monitor outcomes to see if these goals were met. In this case however, the government's goals are multiple and sometimes inconsistent and poor data make high quality monitoring difficult if not impossible. If we are to understand and manage the sector better, we need to improve these data as soon as possible.

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HOW MANY LANDLORDS ARE THERE IN THE UK?

To understand the effects of the various changes discussed in this document, it would be helpful to know the number of private individual landlords in the UK. Unfortunately there is no good statistical source for this number, but there are various ways of estimating it.

Method 1

We can look at what surveys tell us. The Wealth and Assets Survey asks if the respondent owns 'Buy-to-let property in the UK (residential property which is let for profit)' (ONS 2012). Results from 2012-2014 (the most recent available) indicate that 4% of British households reported owning such property (ONS 2015). The ONS estimates there were 27.0 million households in the UK in 2015, and 4% of that is 1.08 million households.

Method 2

We could impute the number by pulling together information about the number of private rented dwellings and the distribution of the number of properties owned by each landlord. The latest UK-level figure for the number of PRS dwellings is 5,174,000 in 2013 (DCLG Live table 101). For England there is a more recent 2014 figure of 4,588,000, which was up 2.75% from 2013. If we apply this 2.75% growth rate to the overall UK figure, and assume that growth continued at the same rate into 2015, we come up with an estimate of 5,460,000 PRS dwellings in the UK in 2015.

The 2010 Private Landlords Survey (although it must be remembered was quite a small sample) indicated that some 40% of PRS dwellings were owned by landlords who own only a single property. Assuming that that proportion has remained constant,

the number of landlords owning a single rented property is

$$5,460,000 * .4 = 2,184,000$$

Again from the 2010 Private Landlords Survey, some 78% of landlords fell into this category. This means a further 22% of landlords own more than one property, so

the number of landlords owning more than one property is

$$(2,184,000/78) * 22 = 616,000$$

and the total number of landlords is

$$2,184,000 + 616,000 = 2,800,000$$

Finally, the 2010 Survey tells us that 89% of landlords are private individuals.

The number of private individual landlords is therefore

$$2,800,000 * .89 = 2,492,000$$

In this context it is important to remember that the survey was undertaken in 2010 and this figure assumes that proportions have all stayed the same while the sector has increased by over a million units. The probability is that those holding more than one unit have become more important - in which case this figure is an upper estimate.



Method 3

HMRC data should tell us something about the number of landlords, as they must pay tax on their rental income. (However, the fact that HMRC is running a high-profile 'Let Property Campaign' to encourage small residential landlords to pay tax indicates that not all do.) According to data for 2012/13 (the latest available), some 1.63 million individuals reported receiving rents from UK property. This is a very rough indicator, since the category also covers commercial and agricultural property and, as noted above, not all residential landlords comply with their tax obligations.

Method 4

Scotland, Wales and a number of local authorities in England require all landlords of properties in their areas to register. Based on the number of private individual landlords registered in each jurisdiction it should be possible to estimate a range for the entire UK. However we have been unable to find published statistics for the numbers registered.

Table A1 summarises the estimates made using the various techniques. They range from 1.08 million households to 2.49 million individuals. This highlights the problem of missing or contradictory data around landlords in the UK.

Table A.1: Various estimates of number of private individual landlords in the UK

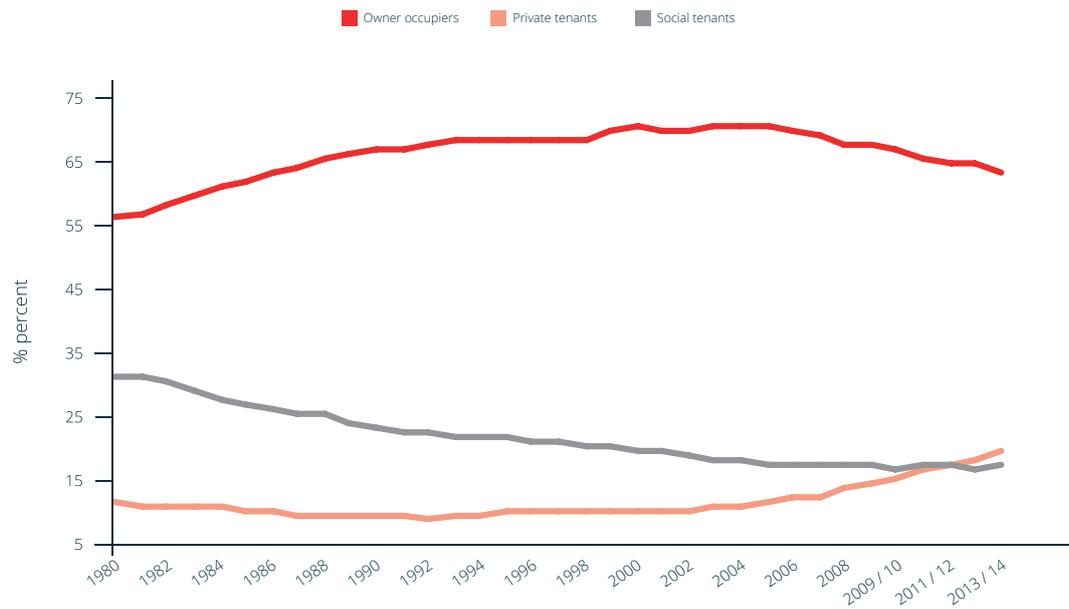
| Method | Estimate | % of total (27 million households/49,093,000 adults) |
|---|--------------------------|---|
| 1 Gross up from Wealth and Assets survey | 1.08 million households | 4% of households |
| 2 Impute from data about numbers of dwellings and distribution of landlord holdings | 2.49 million individuals | 9% of households (if only one landlord per household) 5% of adults |
| 3 HMRC data on number of individuals reporting property rents | 1.63 million individuals | 3.3% of adults |
| 4 Estimate based on numbers registered in areas where it is required | N/A – data not available | |

Source: Wealth and Assets Survey; author's calculations; ONS; HMRC

COMPARING RENTING TO OWNER-OCCUPATION

Figures A.2.1 and A.2.2 show how the pattern of tenure has changed over time in terms of tenure in England - with owner-occupation still the majority tenure but declining significantly in proportional terms and the numbers of private tenants rocketing from the early 2000s.

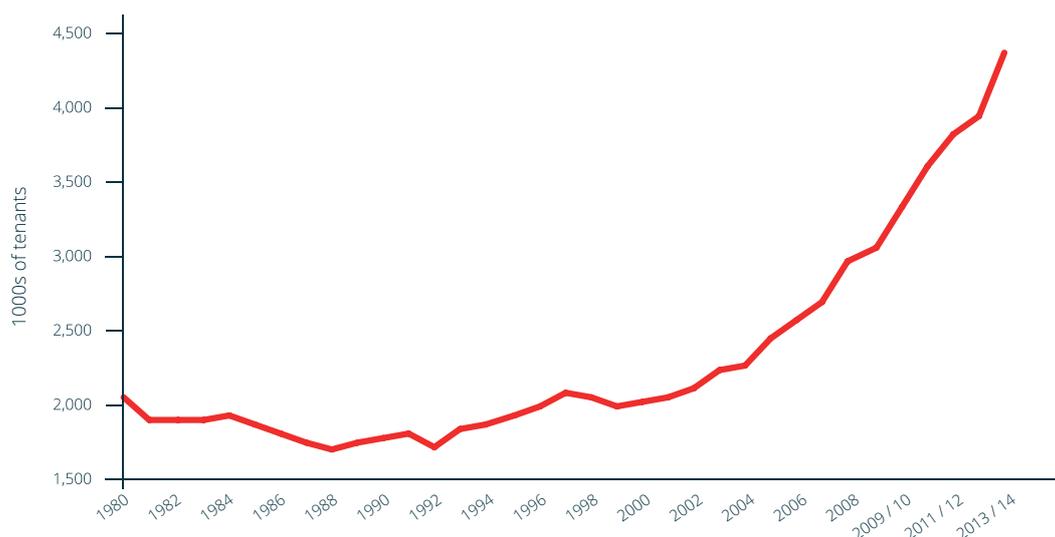
Figure A.2.1: Housing tenure from 1980



Source: DCLG Live Tables



Figure A.2.2: Number of private tenant households in England, 1980-2013/14

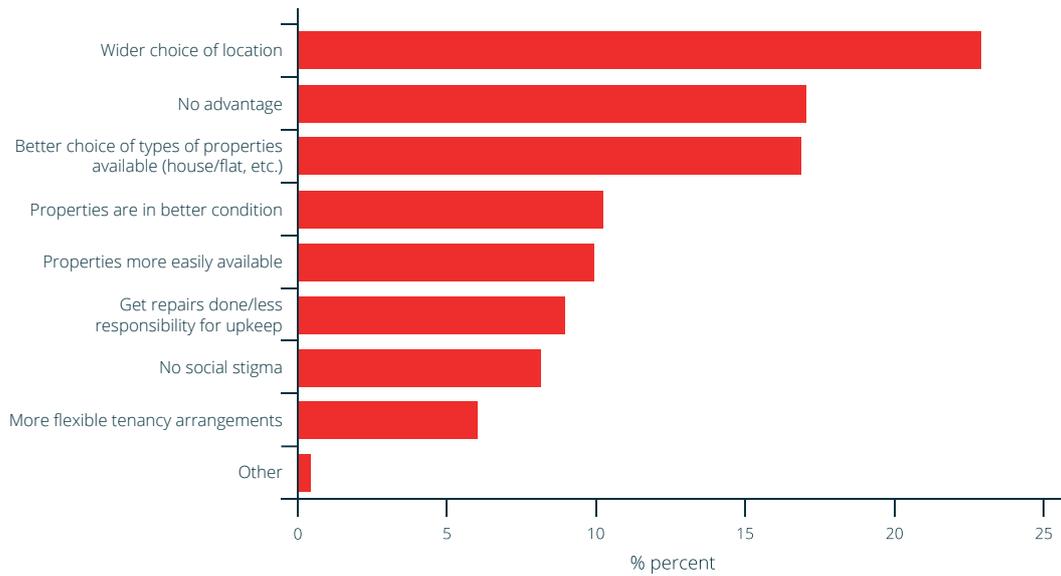


Source: English Housing Survey 2013/14

In some circumstances private renting offers distinct advantages over owner-occupation (Figure A.1). Young, mobile professionals may want the freedom to move to other neighbourhoods, cities or even countries without the commitment of home ownership. Landlords are responsible for maintenance and repairs, which some tenants greatly appreciate. There has been a steady increase in property-transactions costs over the last decades – so renting privately allows tenants to try out particular areas before making a costly long-term commitment. And private renting benefits the wider economy by facilitating labour mobility.

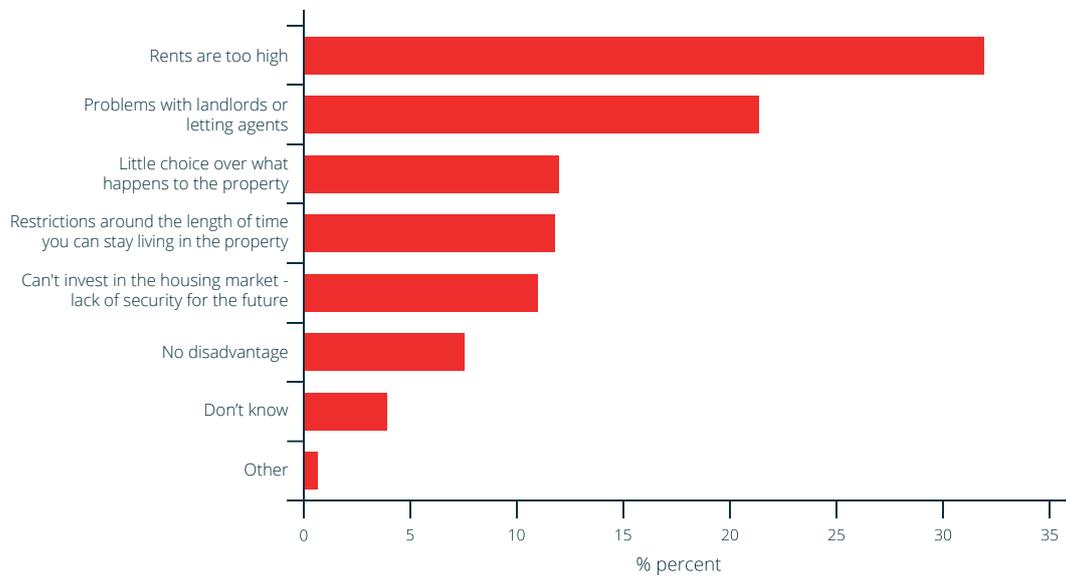
For lower-income households social housing will usually be the preferred tenure, for several reasons. First, it is less expensive in most areas, and secondly the standard tenancy has been indefinite—that is, the tenant can stay for life (although the government has announced plans to change this in future). Social renting also offers an affordable route into owner occupation for many households through the Right to Buy (for council houses) or the soon-to-be-implemented Voluntary Right to Buy for housing association tenants. However location and quality may still be an issue for some potential tenants, especially in areas where social rents are close to market levels. Even so, in almost all Southern England and in many areas in the rest of the country only more vulnerable tenants and homeless households can access social housing – so it is not an option for most of those entering the PRS.

Figure A.2.3: Main advantages of renting privately



Source: British Social Attitudes Survey 2010

Figure A.2.4 Disadvantages of renting privately



Source: British Social Attitudes Survey 2010

There are downsides to private renting compared to owner-occupation or social renting. For more affluent households in particular, owner-occupation is the favoured tenure because it offers full control over the property, security of tenure—which is seen as particularly important in the case of families with children - and the possibility of capital appreciation (Figure A.2). Thus the very great majority of middle-income households, with or without children, own their own homes.

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