

# **Proposals for regulation of the private rented sector: an analysis**

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# Executive summary

## *Main findings*

- International experience suggests two important lessons for private renting in London:
  - In terms of regulation, the starting point matters less than the fact of change, and uncertainties about future change, both of which upset the market:
  - Most other European countries treat landlords more generously for tax purposes than does the UK, which helps to ensure that landlords want to remain in the market.
- More than one in four London households now rent privately—and one third of these households include children. This is a situation that was inconceivable only a few years ago.
- This has generated increasing concern around the lack of security of tenure, especially for families. The UK has some of the shortest leases in Europe while the typical lease in many other European countries is indefinite. The Scottish Government, which has devolved responsibility for housing, has already published legislation creating indefinite tenancies.
- Equally the growing importance of the sector and the increases in private rents, particularly in London, have led politicians to re-open the question of whether to regulate rent increases—an issue considered closed in England since 1988.
- A number of the Mayoral candidates have spoken out in favour of some form of rent stabilisation as well as longer leases. Some may well include options in their manifestos even though currently the Mayor only has advisory powers.
- Many countries with long or indefinite tenancies together with indexed rent increases within tenancies have large private rented sectors, suggesting that strong regulation does not of itself cause the PRS to shrivel. But the effects of PRS regulation are very strongly conditioned by national and local legal, fiscal and cultural environments. Moreover, it is not so much the baseline but *changes* to regulation which affect landlord behaviour.
- One favoured package of measures for London would consist of three- to five-year tenancies with initial rents set by the market but rent increases within the tenancy limited to inflation. Such a package would benefit existing tenants and households that value certainty. It would cause some small landlords to leave the sector and make remaining landlords more selective in choosing tenants, thus reducing supply and making it harder for new tenants to find accommodation.
- Tax changes in the July 2015 Finance Bill which reduce mortgage tax relief and wear-and-tear allowances will make letting less attractive for some buy-to-let landlords and those offering furnished accommodation. These changes will negatively affect yields and, together with the possibility of rent regulations and tenure security, increase uncertainties for landlords.

## ***The Report***

### *Aims of the research*

The National Landlords Association commissioned this research into policy proposals for the private rented sector in mid-2015. This report reviews the content of proposals put forward before the national elections in May 2015 and in the London Mayoral election campaign so far; analyses the effects the proposals might have on different groups of tenants and landlords; and summarises the relevance of Scottish and international experience.

### *Methods*

We gathered information about policy changes proposed by candidates, political parties and interest groups, then carried out a short review of existing evidence about the effects of such policies. We looked at evidence from the UK and from other countries where similar, or apparently similar, regulations are already in place and developed a framework with which to analyse the impacts of policy change.

### *Policy proposals*

#### ***London Mayoral election***

The London election campaign does not officially begin until March, and candidates will not publish formal manifestos until early 2016. Housing has emerged as the single most important issue in the contest. Rents and affordability in the PRS (and associated issues around tenure security) are key issues particularly for Sadiq Khan, Caroline Pidgeon and Sian Berry, all of whom have expressed support for a degree of Mayoral control over rent increases and/or initial rents. Zac Goldsmith has also criticised rising rents and uncertain tenancies, but has given no specifics about how he would address them.

#### ***National election manifesto proposals and outcomes***

The proposals in the UK manifestos of political parties related largely to length of tenancy and associated rent regulation. All parties wanted to see longer leases and more predictable rents within the tenancy period, but the proposed implementation methods varied. Suggestions ranged from voluntary model-tenancy agreements to compulsory three- to five-year leases with indexed increases within the tenancy. Plaid Cymru advocated rent limits on new tenancies and the Green Party said they would consider them, but no main party advocated rent limits on new leases.

Since the election, the Conservative government has tightened regulation on standards in the private rented sector and introduced tax changes for landlords. They have produced a new model-tenancy agreement that explicitly encourages longer tenancies, but have introduced no new regulations around rents or security of tenure.

### *Effects of one favoured model*

Regulatory changes modify the incentives for landlords to let and on what terms. Landlords' responses to changes in the regulations around tenure security and rent increases within a tenancy would vary depending on their reasons for being in the sector. Those seeking a secure income stream (which includes most institutional investors) would be least affected, and

indeed some might consider the changes beneficial. Landlords looking mainly for capital gains would find their options reduced. All types of landlord could be expected to respond negatively to higher costs of letting and particularly to uncertainty around policy reform.

Many tenant households want the freedom to move and would gain little from longer tenancies and within-tenancy rent stabilisation. However an increasing number of households, especially those with children, would benefit from greater long-term security and stabilised rents.

### *Relevant experience elsewhere: rent, tenure and taxation*

#### **Rent regulation and tenure security**

In **Scotland** new legislation effectively creates indefinite tenancies in the PRS and allows local authorities to request indexation of rent increases within the lease in high-pressure areas. The Scottish government has been working to attract institutional investment, but the new regulations are expected to dampen investors' interest at least in the short term. In **Germany** the PRS is the majority tenure and houses a full range of households. Tenancies are indefinite and rent rises within the tenancy are related to local average rents. However initial rents can be well above current market levels in areas of high housing pressure and controls have now been introduced in high-costs areas including Berlin, Hamburg and much of Bavaria. **San Francisco** provides one of the best examples of traditional rent control, which applies to most rental apartment buildings. Leases are indefinite and in-tenancy controls on increases hold them well below market levels. There are massive shortages of rental properties and strong incentives to gain vacant possession by paying compensation to tenants. Rent controls are a highly political issue.

#### **Taxation**

The taxation of landlords in the UK is already less favourable than in many other countries because of the treatment of depreciation. Recently announced changes to the rules around deductibility of mortgage interest and depreciation will make the disparity greater.

In the July Summer Budget the Government announced that tax relief on buy-to-let mortgages would be restricted from 2017. All individual landlords who pay higher- and additional-rate tax and have buy-to-let mortgages will see their tax bills increase, as will many who pay lower-rate tax. This is out of line with practice elsewhere; most countries permit landlords to deduct mortgage interest payments from rental income as a business expense at their marginal tax rate.

It was also announced that from April 2016, landlords of furnished accommodation will no longer be given a 'wear-and-tear' allowance of 10% of the rent, but will instead be able to deduct actual expenditure on renewal of furnishings. In many countries, rental property is treated as a depreciating asset and landlords may offset a proportion of the property's value against rental income for tax purposes. This is not permitted in the UK; the wear-and-tear allowance was conceptually similar although it applied only to landlords of furnished property. Its elimination makes the gulf in tax treatment wider.

## *Conclusions*

Increases in regulation are being introduced or contemplated in a number of major cities in Europe—notably Berlin and Paris—as well as in London. These initiatives reflect growing housing-market pressures, rising rents and difficulties faced by many working households in finding affordable housing.

The possibility of introducing legislation to provide longer leases and more predictable rent rises was much discussed in the UK national elections. However the Conservative majority government that was elected has confined its remit to modifying regulation to improve standards. In addition the July budget introduced cuts in mortgage tax relief for some buy-to-let landlords as well as modifying wear-and-tear provisions for furnished lettings. On the demand side, housing benefit has been cut back. Taken together these changes will have a negative impact on landlord incentives. A number of Mayoral candidates are looking to introduce different forms of longer leases and within tenancy rent stabilisation. Currently they do not have powers to enforce such changes: these continue to lie with central government.

International experience suggests that it is not so much existing regulation that impacts on landlord and tenant behaviour but rather changes in that regulation and uncertainties about future changes. It also suggests that most countries have tax regimes that are more generous to landlords than in the UK, especially given the changes to be introduced in the next few years.

London needs more good quality private rented housing and more landlords who are happy to provide stability with respect to rents and length of tenancy. We hope that whoever is elected Mayor can take positive messages from this report.

# 1. Background

Housing policy, and particularly the role of the private rented sector (PRS), is emerging as one of THE key issues in the campaign for London Mayor. Property prices and rents in the capital continue to rise as housing supply fails to keep up with demand, and affordability in the PRS is increasingly seen as an issue that could affect London's overall economic competitiveness. Much of the political debate centred on the problems facing those households—especially families with children—who prefer stable, long-term housing but are unable to access either owner-occupation or the social rented sector. The existing model of short-term tenancies and unregulated rents was said to serve them poorly, and the debate before the national election showed there was increasing interest in modifying the system.

Political parties and interest groups differ about whether the system should be changed, and if so how best to do so. The National Landlords Association commissioned this research in order better to understand the policy proposals that have been put forward in relation to the PRS, first in the run-up to the national elections in 2015 and now looking forward to the Mayoral contest in 2016. We were asked to explore the likely economic and social effects of the measures on various market actors including landlords and tenants, but also on other housing providers and government bodies. The emphasis in this final report is on the proposals emerging from the four major candidates for Mayor, and on the relevance of international experience to these proposals.

## 2. Methods

We gathered information about policy changes proposed by candidates, political parties and interest groups, then carried out a short review of existing evidence about the effects of the policies proposed. We looked at evidence from elsewhere in the UK and from other countries where similar, or apparently similar, policies are already in place,

Drawing on this material and the analytic literature on the PRS, we developed a framework which allowed us to assess the likely impact of individual policy changes on the incentives for different groups of landlords to provide accommodation, for different groups of tenants to demand that housing, and thus on the price and availability of private rented accommodation.

## 3. The national election: proposals for change

The campaign leading up to the May 2015 general election demonstrated the range of policy ideas with political currency. Some of these ideas had a long incubation period at London level as well as nationally—see for example the 2013 report of the London Assembly, which called for the introduction of some form of rent stabilisation in the capital (London Assembly 2013). The proposals of the main political parties developed as follows:

### ***The Labour Party***

In 2012 the Labour Party conducted a policy review of private rented housing. This produced a series of documents about different aspects of the legal and regulatory framework, including lettings agents, standards and (most relevant for this report) 'providing stability and affordability for renters and families' (Labour Party 2012). The report set out the case for longer tenancies for tenants who wanted them, saying that 'rent could be indexed for the duration of that tenancy. We will consider the most

appropriate type of indexation...’ (ibid p. 10). It outlined various possible approaches, from a ‘voluntary, incentive-based system to an approach that grants renters more rights in law’. Local authorities might be allowed to decide whether to implement longer tenancies and predictable rent increases in their areas (ibid p. 10).

In return for possibly requiring landlords to offer longer leases, the document said ‘Labour will work with the (landlord) sector to develop a range of possible incentives that will form part of a “something for something” deal for landlords’. These incentives might include supplying tenants from local housing registers, direct payment of housing benefit to landlords, and an easier eviction process for tenants who caused damage or ASB. Finally, the document floated the possibility of changing the fiscal regime for landlords to bring it more into line with practice in other countries. This might include introducing depreciation allowances and so-called ‘negative gearing’ (allowing rental losses to be offset against other types of income for tax purposes). It also mentioned the possibility of ‘making any current benefits of the tax system contingent on landlords offering longer-term stable tenancies’ (ibid p.11).

In a press release about an April 2014 speech by Ed Miliband the party provided more details, saying it would legislate for three-year tenancies after a six-month probation period. Rent increases would be limited within the tenancy, ‘based on a benchmark such as average rents’. Landlords would be able to remove tenants at the end of the probationary period, or for specified reasons within the tenancy with two months’ notice. Tenants would be able to leave at any time with one months’ notice.

In February 2015, with the election approaching, the Labour Party made its policy more explicit. Its website said the party would ‘change the law to make three-year tenancies the norm’ while allowing both landlords and tenants to terminate the contracts earlier with proper notice if they needed to, ‘just as they can now’. It suggested that rent increases within the tenancy would in the first instance be limited to CPI (<http://www.labour.org.uk/issues/detail/renting>). In addition, tenants would be given a legal right to know how much rent was paid by the previous tenant, in order to help them negotiate the best initial rent.

Labour leader Ed Miliband announced that if elected he would create a compulsory national register of private landlords. This register, he claimed, would help HMRC collect some £100 million of tax that landlords had avoided; the money would help fund a three-year stamp duty holiday for first-time buyers. He also stated that the party would reduce tax relief for the upkeep of furnished properties that were found to be substandard.

### ***The Conservative Party***

Communities Secretary Eric Pickles, in a 2013 speech, introduced the idea of a ‘tenants’ charter’ that would give renters the right to request longer tenancies (three to five years). He said the government would develop a model agreement for longer tenancies within the existing legal framework. In September 2014 the Department for Communities and Local Government published this model tenancy agreement, which it said was ‘particularly focussed on supporting tenants who want to negotiate a longer fixed term period at the start of the tenancy’ (CLG 2014). The document sets out the benefits of longer tenancies, saying

‘The Government recognises that there is growing interest in tenancies that have a longer fixed period – e.g. three years. Such agreements can give tenants – particularly families with children – greater certainty and stability to plan for the future. Entering into longer tenancies is also beneficial to landlords as it offers greater certainty on rental income, minimises periods when the property is vacant and avoids the costs associated with finding new tenants. It also means that neither tenants nor landlords need to pay fees to renew a tenancy.’ (ibid p. 1)

This model contract does not specify a period. It suggests that for terms of less than two years, the rent should remain the same throughout, while longer tenancies should permit a maximum annual rent increase—either a fixed percentage or by CPI. For tenancies of two years or longer under this model agreement, the tenant is permitted to break the tenancy with three months’ notice at any time after the first three months. Landlords have a one-off break clause at six months, and also may gain possession for specified reasons (e.g. non-payment of rent) at any time.

## ***Other parties***

### *Liberal Democrats*

The Liberal Democrats proposed a Help to Rent scheme for young people. This would provide low-interest tenancy deposit loans of up to £2000 (in London) for first-time tenants under the age of 30. They said they would implement a new multi-year tenancy with inflation-linked annual rent increases. They would also allow tenants to reclaim their rent from landlords whose properties had serious health risks, and withhold rent if landlords did not carry out court-mandated improvements expeditiously.

One of the Liberal Democrats’ most publicised policies, the ‘rent-to-own’ proposal, would not have affected private landlords as it would have been run in collaboration with housing associations.

### *The Green Party*

The Greens proposed five-year tenancies with inflation-linked increases. They also promised to establish ‘Living Rent Commissions’ that might propose policies to bring rents into line with local incomes. They pledged to remove tax relief on mortgage interest payments for private landlords entirely, using the money thus raised to fund construction of new social housing.

### *Plaid Cymru*

Plaid Cymru pledged to introduce minimum 18-month to two-year tenancies and rent control, although it did not provide details of how this would work.

## ***Other issues***

During the campaign there was almost no discussion of no-fault eviction at the end of a lease, or indeed of retaliatory eviction (which was to some degree addressed by changes put in place by the coalition government).

If three-year leases did become the norm, there would be a question as to how market rents for extension should be determined. Going forward, this and other issues are likely to generate a range of uncertainties.

Table 1 summarises the main pre-national election proposals around tenancy security and rent regulation, including some proposals from think tanks, advocacy groups and Parliamentary committees.

**Table 1: Pre-election policies on PRS tenancy length and rent regulation: Political parties, advocacy groups and Parliamentary committees**

<i>Organisation</i>	<i>Policy issues</i>					<i>Voluntary or compulsory?</i>
	<i>Longer tenancies</i>	<i>Rent on new tenancies</i>	<i>Regulate increases within tenancy</i>	<i>Ending tenancy before term</i>		
				<i>By tenant</i>	<i>By landlord</i>	
Labour Party	3 years including 6-month probation	Market	Yes; initially limited to CPI	One month's notice	At six months if tenant 'fails', or after with two months' notice for specified reasons	Compulsory
Conservative Party (current government policy)	Model tenancy. No specified term but intention is more than two years	Market	Yes, either by fixed percentage or CPI	Three months' notice	After six months, or later for specified reasons including non-payment of rent or sale of property	Voluntary
Liberal Democrats	Model 3-year tenancy with 6-month break		Yes by inflation			Voluntary
Green Party	Five years	Possible future caps				Compulsory
Plaid Cymru	18-24 months	Controlled	No details			Compulsory
Shelter	Five years		By CPI	Tenant can give two months' notice at any time	Landlord can break tenancy to sell property	3 options: <ul style="list-style-type: none"> <li>• Voluntary;</li> <li>• Voluntary with tax incentives;</li> <li>• Default</li> </ul>
Crisis	By mutual agreement using existing options		By inflation	Under certain circumstances—e.g. need to move	Landlord can break if needs to sell for financial reasons	Government should 'encourage and incentivise'
CLG Select Committee	Yes using existing options; no term defined		By inflation, wages or fixed percentage			Voluntary

Sources: Shelter 2012; Crisis 2013; CLG Select Committee 2013; NLA 2015; party manifestos

## 4. The national election: outcomes

The Conservative Party won an outright majority in the May 2015 election, In July 2015, Chancellor of the Exchequer George Osborne announced a number of changes to the tax treatment especially of buy-to-let landlords. There had been no prior consultation about these changes, which came as a surprise to the sector.

The income-tax treatment of private individual landlords was made less favourable in two important ways. First, from 2017 buy-to-let landlords will no longer be permitted to deduct mortgage interest payments from their rental income before calculating tax due; instead they will be able to take a credit of 20% of mortgage interest paid. Many basic-rate taxpayers will see no change in the amount of income tax they must pay, but individuals who have buy-to-let mortgages and pay higher or additional-rate tax (that is, those with taxable incomes of over £40,000 per annum from all sources) will see their tax bills increase.

The second change announced was the removal of the provision that permitted landlords renting furnished accommodation to deduct 10% of gross rental income for ‘wear and tear’, regardless of whether they replaced any items in the home. From April 2016 only actual expenditure can be set against rental income.

The tax changes contained in the Summer Budget will reduce the attractiveness of buy-to-let investment for a range of individual landlords. Indeed, this was Government’s intention; HM Treasury’s productivity plan says that the different treatment of mortgage interest advantages landlords over home owners. It says the tax changes will ‘start to shift the balance between landlords and homeowners’ (HM Treasury 2015 p 48). The changes are discussed in more detail in Part 9 of this report.

In October 2015, the government published a new model tenancy agreement, which it said ‘strikes a fair balance between the interests of landlords and tenants’ (DCLG 2015). It is particularly focussed on supporting tenants who want to negotiate tenancies for fixed terms of two years or more. Use of this agreement is voluntary.

### ***Labour policy***

Housing is reportedly the number one policy priority of Jeremy Corbyn, who was elected leader of the Labour Party in September 2015. Corbyn has long advocated radical changes in rent and tenure regulation. In the past he called for granting the right to buy to private tenants while removing it from council and housing-association tenants; the policy would be funded by the removal of tax relief for interest on buy-to-let mortgages. His August leadership manifesto on housing was less sweeping, saying ‘We could also investigate whether some of this money (from removal of tax relief) could be used to fund a form of right-to-buy shared equity scheme to private tenants in cases when they are renting from large-scale landlords’ (Corbyn 2015).

In the same document, he wrote that ‘Regulation of private rents should be linked to what determines whether something is affordable. We should consider average earnings and in particular their rate of increase, not the market rate for housing’ (Corbyn 2015). He cited Berlin, saying that experience there demonstrated that controls on initial rent levels did bring rents down. In addition he has called for mandatory registration and licensing of landlords, and for better enforcement of standards.

## 5. The mayoral election: proposals for change

The election for London's Mayor will take place on 5 May 2016, and the major political parties had selected their candidates by end-September 2015. Formal manifestos will not be published until early 2016, and the candidates are still working on refining and fleshing out policy positions in a number of areas. The policy summaries below reflect candidates' writings and policy statements up to end-November 2015, but it is quite likely that their final policy positions may change somewhat before manifestos are published.

### *Current mayoral powers*

London's mayoral candidates all offer policies for the PRS and argue that the Mayor should be given more powers over housing. It is important to note that the Mayor currently has no power to regulate tenancies or rents in the capital as these are matters for central government. In principle there is the possibility that powers to regulate the PRS could be devolved to the Mayor under the Cities and Local Government Devolution Bill currently making its way through Parliament. However this bill is aimed mainly at the 'northern powerhouse' cities and it is unlikely that the current government will be willing to extend it to London in the near future. The devolution deals requested by cities including Liverpool, Manchester and Sheffield have covered transport, health and skills policy, but in terms of housing have only dealt with planning and new construction rather than regulation of the PRS.

While the Mayor cannot compel landlords to issue longer tenancies or limit rent increases, he can introduce voluntary schemes such as the London Rental Standard.

### *The candidates' positions*

The positions of the major candidates are summarised in Table 2.

#### *Sadiq Khan (Labour)*

Sadiq Khan has made affordable housing a major focus of his campaign. He has promised to establish a London-wide non-profit letting agency that will promote longer-term tenancies (3 to 5 years) with index-linked rent increases. If elected he could do this immediately; other local authorities (e.g. Southwark) operate similar schemes for social lettings, which landlords are free to join if they wish, and the GLA already operates the voluntary London Rental Standard.

Khan has said he will campaign for the London Mayor to be given the power to freeze rents, although he has not indicated in what circumstances he would expect to use this power. He also proposes to require developers to provide a new form of affordable rented housing on new developments; the homes would have a London Living Rent linked to 30% of average local incomes. Such housing would presumably be owned by social rather than private landlords, but as yet there are no details about how the scheme might work. It could be argued that the Mayor already has the powers to implement such a scheme, but this has yet to be tested.

#### *Zac Goldsmith (Conservative)*

Like Khan, Zac Goldsmith has focused on housing, saying 'the housing crisis is my number one priority.' Most of his pronouncements on housing policy have centred on how to increase the amount of new housing built in the capital rather than on private renting. He has said that he would like to see longer tenancies and greater certainty about rent increases, but with no details about how this would be achieved.

*Caroline Pidgeon (Liberal Democrat)*

In a Guardian interview in September, Pidgeon said, ‘We also need to end the scandal of too many young people struggling to rent, let alone buy a property. Unless we tackle these barriers, London will continue to be a city that serves the few, not the many’ (Perraudin 2015). It is not clear however whether she advocates regulatory control of initial rents or rent increases, as she has made no detailed policy statements and her website contains no information about housing policy.

*Sian Berry (Green)*

Like Sadiq Khan, Sian Berry supports the idea of giving the Mayor powers over London rents, and suggested a draft amendment to that effect to the Cities and Local Government Devolution Bill (Berry website 2015). She has made clear that she would favour freezing rents, saying ‘We all agree we need to make it cheaper to rent in London, and with rents already averaging half Londoners’ take-home pay, a cap on rent rises – or even better a rent freeze – could start making a difference to affordability straight away’. She claimed her policies on rent control would be ‘more radical’ than those of other candidates (ibid).

**Table 2: Policies of London Mayoral candidates (November 2015)**

<i>Candidate and party</i>	<i>Policy area</i>			
	<i>Longer-term tenancies</i>	<i>Rent on new tenancies</i>	<i>Rent rises on existing tenancies</i>	<i>Other</i>
Sadiq Khan (Labour)	Has advocated longer-term tenancies (3-5 years) with index-linked rent increases, promoted through London-wide non-profit letting agency		Will campaign for Mayor to be given power to freeze rents	Will require proportion of ‘London Living Rent’ affordable housing on new developments, with rents linked to 1/3 of local average earnings
Zac Goldsmith (Conservative)	Would ‘like to see’ longer tenancies		Will ‘bear down on unsustainable rents’; wants more certainty about rent increases	
Caroline Pigeon (Liberal Democrats)	Wants rental contracts extended			Wants to create ‘rent to buy’ scheme
Sian Berry (Green Party)		Supports Mayoral powers to impose cap on new rents	Supports rent freeze	

Sources: Copley 2015; Khan 2013; Berry 2015; Murphy 2015; Evening Standard 2015; Phibbs 2015

## *Conclusions*

Housing is currently top of the political agenda for the mayoral elections and all candidates will be expected to make commitments to improve housing conditions in London in their manifestos. There will undoubtedly be considerable variation in exactly what is suggested for the private rented sector—ranging from improved regulation of standards and advice as to how to implement longer-term tenancies to proposals for indefinite tenancies and even possibly full rent controls.

The main candidates are likely to make it clear that their current powers are solely advisory with respect to rents and length of lease, with their main role concentrated around improving standards. Those looking to support rent stabilisation and longer leases will seek to negotiate with central government to achieve devolution of these powers. Scotland's use of devolved powers in this context (discussed below) may well count against their chances of success.

## 6. Effects of new policies on landlords and tenants

In looking at the potential effects of policy changes we could simply do a broad-brush examination of expected impacts on landlords and tenants. However, within each group there is huge diversity of financial position, expectations and attitude to risk and return. Grouping stakeholders in terms of their primary interests helps identify the parts of the market that would be most affected.

Landlords can be categorised into three main groups: those who are landlords because of accidental/non-business reasons (e.g. inheritance, plans to use dwelling in retirement or for children); investors looking for total return including both capital gains and rents (who traditionally have relied more on increases in housing values); and long-term investors looking for a secure rental stream. The vast majority of landlords own only a few, indeed often just one, property. Larger landlords usually have more experience of management and intend to be in the market for the longer term.

To simplify the analysis and relate it more closely to suggested changes we here restrict the analysis to four composite types:

- A. ‘accidental’ landlords—those renting out a property they inherited or could not sell
- B. small individual landlords looking for capital gains (i.e. the average buy-to-let landlord)
- C. larger more professional landlords of whatever type who view the PRS as a long-term business
- D. institutional investors, as there has been much discussion in recent years about attracting them to the sector in order to increase new output and improve management.

Policy changes affect landlords’ investment decisions and therefore their preparedness to supply accommodation. The main factors they take into account are:

1. **Rents** (which feed into return)
2. The **running costs** of managing the property (which also feed into return)
3. **Tenancy length** (which affects expectations about future income streams and voids)
4. **Security of tenure** (which impacts on their ability to evict tenants or not renew tenancies, and to adjust portfolios by selling properties with vacant possession)
5. The **risk** that they might want to modify rents or sell up, or that hassle will be increased
6. **Confidence**—certainty about the outcome of change and the likelihood that further regulations will be put in place.

We now turn to the likely effects of specific measures on landlords and tenants. Because of the interaction between tenancy and rents it necessary to look at the effects of a *set* of policies, rather than looking at individual measures. Our stylised set of measures consists of three-year tenancies; in-tenancy rent indexation (assumed to lead to below-market rent increases); and registration plus no fees to tenants. This package draws on the proposals of several of the mayoral candidates and represents a plausible set of measures around tenancies and rents. It is very similar to new regulations being introduced in Scotland (see below).

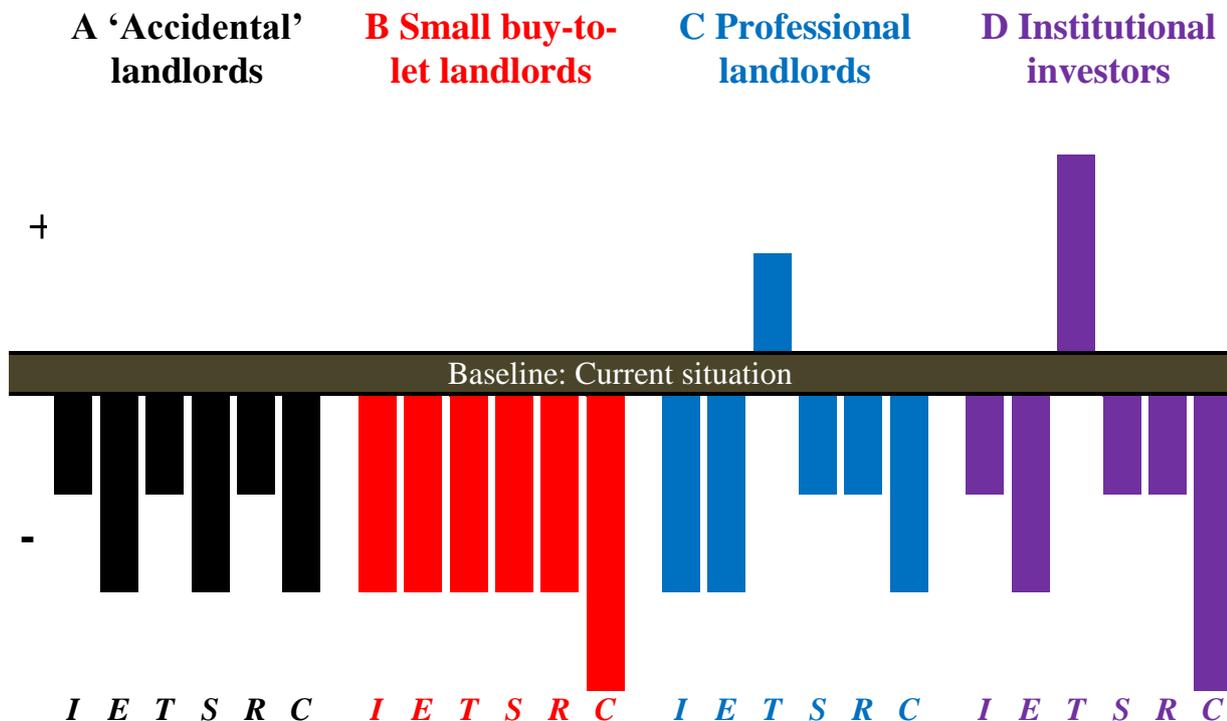
### ***Effects on landlords***

Table 3, based on the existing literature on the motivation and behaviour of private landlords, sets out the likely impacts of such a package on four types of landlord, *as compared to the current situation*. For each landlord type there are six bars, representing the six factors discussed above. Bars that rise above the central line indicate that on balance these landlords will benefit from the proposed changes;

bars that fall below the line show that the changes will be detrimental to these landlords. The height of the bar relates to the anticipated size of the effect—taller bars indicate greater impact.

**Table 3: Illustrative impacts of stylised policy package on four types of landlord**

*Package: 3-year tenancies, below-market indexed rents, registration, no fees to tenants*



<b>KEY</b>	
I	Income
E	Expenditure (running costs)
T	Tenancy length
S	Security of tenure
R	Risk
C	Confidence

The table suggests that most landlords would be worse off after this set of changes. In the short term they would negatively affect all landlord types by reducing rental income and requiring expenditure on registration. On the other hand, many landlords—in particular professionals and institutional investors, who can be assumed to have relatively long investment horizons—would benefit from the greater certainty afforded by longer leases. Confidence would be affected across the board as landlords might anticipate further changes in the system.

Three things should be stressed:

- (i) The impact of limiting rent increases within a tenancy depends on the index chosen, actual running costs compared to the index, and alternative investment opportunities. Clearly there is a relationship between length of tenancy and the capacity to modify rents in line with costs and the market.
- (ii) Short-term impacts can be very different from long-term ones – most importantly because confidence will change, but also because people do not generally adjust quickly, and other

opportunities may increase over time. Thus if underlying fundamentals change such that returns are lower and risks are higher, landlords will disinvest as opportunities arise.

- (iii) There are still few institutional investors in the market. The question is whether and how policy changes would affect their expectations. In our research for Homes for Scotland it became very clear that adequate yield and certainty with respect to regulation were prerequisites for large-scale investment (Whitehead et al, 2013).

### ***Effects on tenants***

Like landlords, tenants are a far from homogeneous group. Some expect to live in the PRS for the long term and would benefit from policies designed to improve its ability to provide permanent homes. Others are in the tenure precisely because it is *not* permanent—they value flexibility and easy access. The average length of a tenancy is considerably longer than the current AST, but different groups assign very different values to certainty about lease extensions or renewals. Existing tenants with higher incomes and wealth have more choice in the residential market and are therefore more likely to have chosen private renting because its attributes suit their needs.

In terms of how tenancy length and rent regulation would affect tenants, we can identify three groups:

- A. younger households consisting of single people (often sharing), who usually expect to stay a relatively short time;
- B. family households looking for longer-term stability who cannot access other tenures; and
- C. employed households who are expecting to move on—although when may be unclear.

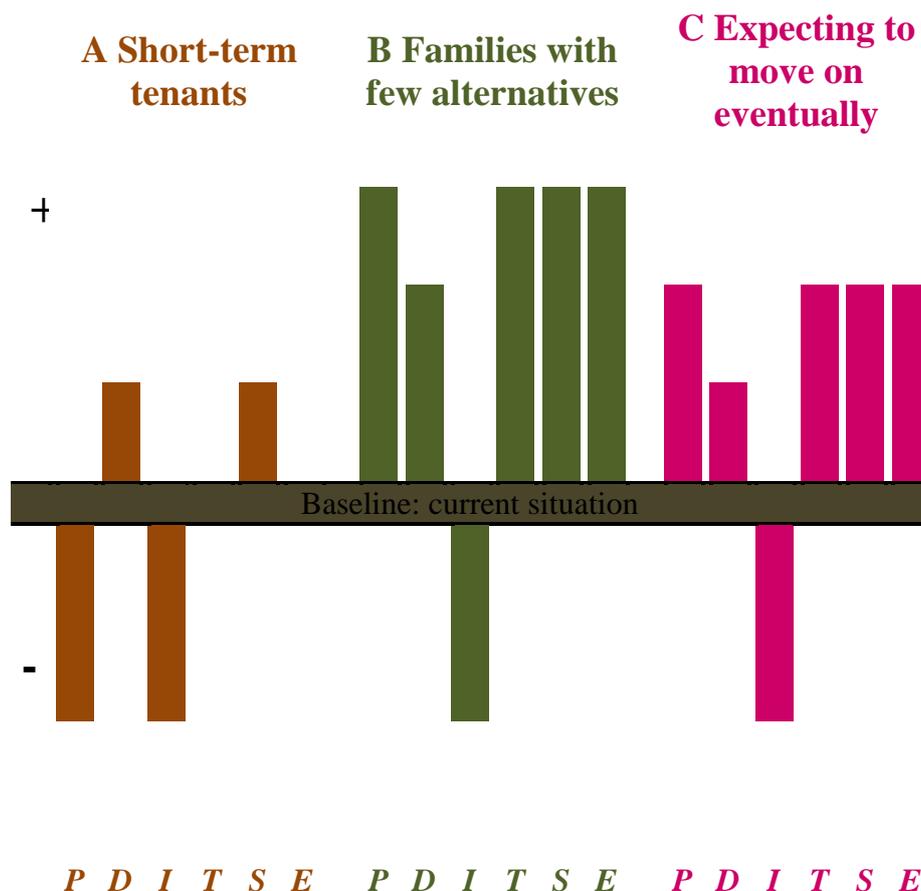
There are three ways in which the proposed package of policy changes might affect tenants. It could influence

- 1. their ability to ***find accommodation***;
- 2. the ***rent*** they have to pay; and/or
- 3. their ***certainty*** about length of stay and rents.

Table 4 summarises the potential impacts of the same stylised package of policy changes on the three categories of tenant identified above. The literature suggests that in this regulatory environment, the limit on rent rises within the tenancy will mean that *initial* rents on new leases will be higher than they otherwise would be – so tenants who are not looking for security end up paying more. How much more would depend on any negative impact on the number of new lets and the extent of demand in the marketplace. Entry costs for tenants will be reduced directly by the removal of fees but will be increased indirectly if these are added to the rent and/or supply declines.

Table 4 suggests that many tenants would benefit from these proposals. This is particularly so for families with children, who would enjoy greater certainty about future rent payments and the ability to remain in their homes. However not all tenants would benefit. Because landlords would charge higher *initial* rents in this system (so as to offset limits on the ability to increase rents in future), those requiring short-term accommodation would pay more than they do now. And all types of tenants would face higher indirect entry costs, as landlords would be more selective if choosing a tenant had definite long-term implications.

**Table 4: Illustrative impacts of stylised policy package on three types of tenant**  
*Package: 3-year tenancies, below-market indexed rents, registration, no fees to tenants*



<b>KEY</b>	
P	Rent payments
D	Direct entry costs
I	Indirect entry costs
T	Length of tenancy
S	Security of tenure
E	Risk of eviction

What is obvious is that these proposals would mainly benefit tenants, but only certain groups of tenants--in particular those who want and achieve longer and more stable tenancies. New and short-term tenants would suffer because of reductions in supply, increased initial rents and greater risk aversion among landlords. How large the impact would be depends on the exact form of the proposals that were introduced. It would also depend on how quickly uncertainties about the changes in regulation could be resolved and particularly on the opportunities to sell to owner-occupiers.

## 7. Parallels with Scotland

Several of the London mayoral candidates have indicated that they will seek greater powers over housing policy. It is therefore relevant and interesting to look at what is happening in Scotland, where housing is a devolved matter for the Scottish Parliament. In recent years the housing policies of England and Scotland have diverged significantly. This is particularly obvious in the case of policies around private renting.

At the moment, tenancies and rents in the private rented sector are treated very much the same way in England and Scotland, apart from some differences in nomenclature (the equivalent of England's Assured Shorthold Tenancy is known as a Short Assured Tenancy in Scotland). There is no control of initial rents or rent increases; the minimum tenancy is six months and tenants have no right of renewal; and landlords can ask tenants to leave at any time after the end of a lease without giving a reason.

As in England, the PRS in Scotland accommodates an increasing proportion of households. This includes a growing number of families with children, who are seen to be ill-served by the existing short-term tenancies and no-fault evictions. The Scottish government produced an overall PRS strategy in 2013 (Scottish Government 2013). As part of this strategy it asked a panel of experts led by Prof Douglas Robertson of Stirling University to look at PRS tenancies, and that panel recommended that tenancies be modernised (Robertson et al, 2014).

Following two rounds of consultation, the Private Housing (Tenancies) Bill was published in Edinburgh in early October. It is now making its way through the Scottish Parliament and is expected to become law in early 2016. This bill effectively introduces unlimited tenancies in the PRS. Landlords can require tenants to leave only for specific grounds set out in the law; 'no-fault eviction' when a tenancy finishes will no longer be possible.

The bill limits rent increases to one per year, with three months' notice. Tenants can refer rent increases to a tribunal if they believe the new rent exceeds average rents in the area. Local authorities may ask the Scottish Government to designate all or part of their areas as 'rent pressure areas', a designation which lasts for five years. In such areas local authorities can cap rent increases; the lowest permissible cap is CPI+1%.

The new Scottish system is similar in some respects to what has been proposed for London by candidates such as Sadiq Khan and Sian Berry. However the focus of change in Scotland has been far more on security of tenure, with the introduction of indefinite leases and the removal of no-fault eviction. There is provision for limits on rent increases but these would apply only in designated areas and would be inflation-linked. In London by contrast the debate has centred more on affordability, with proposals for rent caps and rent freezes. This difference in emphasis reflects the different political and economic pressures in the two areas: PRS rents are perceived to be high almost everywhere in London but in Scotland affordability is much less of an issue outside Edinburgh, Aberdeen and parts of Glasgow.

The Private Housing (Tenancies) Bill has been broadly welcomed by tenants' groups and housing charities, while landlords have warned that it will deter new investment and lead existing landlords to reduce their portfolios. However the bill is not yet law in Scotland, so it is too early to assess its effects.

## 8. International experience: tenancy length and rents

The following section briefly sets out the situation in five places where there is more legal control of rents and tenancy length than in the UK: Ireland, Germany, France, the Netherlands and San Francisco. This section draws heavily on Whitehead et al (2012), which contains a more general discussion of regulatory regimes across Europe, and on Scanlon & Whitehead (2014).

### *Ireland*

Ed Miliband pointed to Ireland as a model in terms of how it handles regulation of the PRS. In reality, Ireland deregulated and reorganised the market with the aim of generating higher quality rental housing rather than lower rents.

Rent controls were abolished in 1982 in Ireland, and since then rents have remained largely unregulated. The 2004 Residential Tenancies Act however did stipulate that initial rents could be no greater than the market rent, and that rents within a tenancy could only be changed once a year and could not be greater than the open-market rate (Department of the Environment, Heritage and Local Government undated). Landlords in Ireland are required to register tenancies and rents, and the Private Residential Tenancies Board produces market-rent statistics as a benchmark. Rents may be reviewed either up or down only once a year unless there has been a substantial change to the property. Tenants must be given 28 days' notice of new rents, and may ask for a review if they feel they exceed the market rate for the property. Disputes can be referred to the Private Residential Tenancies Board (PRTB).

Security of tenure was strengthened by the Residential Tenancies Act 2004, which introduced standard four-year tenancies. Landlords are permitted to terminate a tenancy without giving a reason during a six-month probationary period, but after that (and up to four years) the landlord can only end the tenancy for one of six specified reasons (non-payment of rent, overcrowding, intended sale etc.). After four years a new tenancy commences and the process starts again. Notice periods for both landlords and tenants increase in line with the tenancy's duration, to a maximum of 112 days for landlords and 56 days for tenants (Norris 2011).

There have also been significant moves in recent years to improve the minimum standards of private rented housing. Regulations introduced in 2009 aimed to improve cooking, heating and laundry provisions, set minimum space and storage provisions to facilitate family living, required landlords to maintain the exteriors of dwellings and completely phased out the traditional 'bedsit' (with shared facilities) by 2013 (Hayden et al. 2010).

The introduction of higher standards and increased security were generally welcomed and are thought to have improved conditions. However the PRS remains a relatively small part of the housing system, generally accommodating more mobile households but also a significant proportion of lower-income households who cannot obtain social housing.

Ireland is now experiencing a housing crisis that affects all tenures. Rents have been increasing rapidly, especially in Dublin, partly because of a near-standstill of new housing production. There is increasing political discussion about the reintroduction of some form of rent stabilisation. Under the existing system, rents within existing tenancies can only be raised once a year, but can go up in line with market rents rather than being linked to a cost-of-living index (as the Labour Party proposal envisioned). The Dublin market saw rent rises of 9.2% in the first seven months of 2014, meaning that even sitting tenants experienced dramatic increases in rents. According to a recent government-

commissioned report, ‘There is a general consensus that the private rented sector is in crisis in certain locations’ (DKM 2014). One suggestion has been that the government should limit rent increases to CPI unless there are significant upgrades to the property. In September 2015 the Minister of Environment announced that the government might bring in legislation to link residential rents to the rate of inflation and temporarily control soaring rental costs.

## **Germany**

In Germany as a whole nearly 50% of households rent their homes, and in Berlin the figure is almost 90%. Most rented housing is privately owned—even ‘social’ housing is owned by private investors (individuals or companies) and rented to low-income households for a limited period as a condition of subsidy. Many middle-income German families use rented housing as permanent homes. Security of tenure is strong and tenants can customise their accommodation, so renting has many of the features of owner-occupation in other countries.

Until recently, across Germany rents on private rented housing could be freely set on initial letting, although charging rents ‘substantially higher’ than the average for similar properties (in practice more than 20% higher in most areas [Kemp & Kofner 2010]) was a criminal offence. Recently however rapidly rising rents have brought pressure for change in some cities, and new rules allow municipalities with ‘stressed’ housing markets to cap rents on new leases to 10% over the average for similar properties. These rules have been adopted in Berlin, Hamburg and many cities in Bavaria and now cover about 4 million rental dwellings. Analyses undertaken just before the rules came into effect showed that in some areas most properties for rent (up to 86% in certain neighbourhoods) had rents in excess of levels that the new regulations would permit.

Within a tenancy, rent rises are controlled in one of several ways, depending on the municipality. The lease contract may specify an annual rent increase (*Staffelmiete*) or state that rents will rise in line with a cost-of-living index, but these options are little used. In practice most rents go up by the average in the local area. There are three methods of determining what this average is: first, mirror-rent tables (*Mietenspiegel*); second, expert opinion; or third, looking at rents for three comparable units in the same area.

The *Mietspiegel* system was set up in 1982 as a way to provide objective empirical data about local rent levels. About 300 municipalities produce *Mietspiegel* tables, which they update every two years. These tables are based on data about dwelling characteristics and rent levels for tenancies started in the preceding four years. The information is provided by tenants and landlords’ associations or, in bigger cities, comes from specially commissioned surveys. Some cities provide relatively simple tables relating rents to dwelling size and date of construction (e.g. Cologne<sup>1</sup>). Others produce what are known as ‘qualified *Mietspiegel*’ based on hedonic regression analysis. These include a much greater range of variables.<sup>2</sup> There are proposals in some municipalities to modify indices with the intention of increasing controls on in-lease rises but these are not yet in place.

Rents can be raised at most once every 15 months, and by a maximum of 20% over three years unless the dwelling has been modernised or benefited from energy-efficiency investment. In this case the landlord can charge 11% of the investment cost every year. Because this is one of the few ways landlords can achieve significant rent increases it has led to a high level of energy-efficiency investment in the German rented stock.

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<sup>1</sup> <http://www.koeln.de/immobilien/mietspiegel.html>

<sup>2</sup> See for example information about the most recent *Mietspiegel* survey in Munich here: <http://www.muenchen.de/rathaus/Stadtverwaltung/Sozialreferat/Wohnungsamt/Mietspiegel.html>

German leases are indefinite—the tenant generally has the right to remain in the dwelling until he or she dies. Fixed-term contracts are only permissible in certain limited circumstances. On the death of a tenant the contract passes to the tenant’s heir(s); the landlord is permitted to give notice and cancel the lease if the heir did not already live in the dwelling. The lease binds the new landlord if the dwelling is sold.

There are a few specific reasons for which the landlord is permitted to evict a tenant: if the tenant has rent arrears of three months or more; if they are causing a nuisance; or if the landlord wants to use the property for themselves or a relative to live in. The landlord’s notice period in such cases depends on the duration of the tenancy and is up to nine months. The tenant on the other hand can leave at any time with three months’ notice. Tenancies can be transferred to another tenant with the landlord’s permission.

German tenants and landlords expect properties to be rented for the long term, and to be in every sense the tenant’s home. They are rented ‘bare’—that is, they are unfurnished and usually do not even contain kitchens; the tenant is expected to purchase and install their own. This clearly affects the tenants’ incentives to remain in the same property.

One reason the regulatory system has worked so well in Germany is that house prices have fallen in real terms and often in money terms for the last two decades. General inflation has also been low. However since 2007 this position has changed in some major cities. Prices and owner-occupation rates have been rising, and rental markets are beginning to silt up in high-demand areas, with queues for rented properties resulting in people having to bid for dozens of units (including providing significant documentation). There is considerable evidence that new investment is not keeping pace with demand.

## **France**

For many decades in France there was no initial rent control except on rental units built prior to the 1948 Rent Act. A typical lease is for three years and there is a right to negotiate a further lease unless the landlord wishes to use or sell the property or the tenant causes serious problems. Since 2008, annual rent increases have been governed by the Rent Reference Index (IRL), based on the cost-of-living index. The rise in the IRL since 2011 led to a rapid increase of private rents especially in Paris and other major French cities.

The ALUR Act (*l'accès au logement et un urbanisme rénové*), passed in March 2014, links rents on new leases to the previous rent for the dwelling or to median rents in the area. The latter system is intended to apply in Paris and 28 high-pressure areas. In these cities, rents on new leases would be limited to 20% above the local median rent as determined by local ‘rent observatories’—new bodies set up to collect rent data. In September 2014, after criticism from landlords and investors, the government scaled back the plans and announced that the controls would be introduced experimentally in Paris only. They have been effect in the French capital since July 2015.

The new law also has some benefits for landlords. It caps taxes on rental earnings for properties in shortage areas, and creates a government-run rent insurance fund to which both tenants and landlords must contribute. If a tenant defaults the landlord can apply to the fund for reimbursement.

## **The Netherlands**

The Netherlands has the largest proportion of social housing in Europe at 1/3 of the stock, and many middle-income families live in the sector. Private rental now accounts for only 10% of dwellings and its share continues to decline. Much is owned by long-established private companies seeking regular

income. Some such owners are now aiming to realise value for their ‘pension funds’ by selling into owner-occupation.

Social and private rental housing are covered by the same regulations around rent and tenure security. For most rented housing, rents are set via a ‘points’ system. Points are allocated for characteristics such as the size, condition and facilities of the home<sup>3</sup>, as well as the characteristics of the local environment (transport, shops, schools etc.)—but not for the desirability of the location. The number of points determines the maximum rent that can be charged. A new tenant has six months in which they may challenge the rent before the Rent Commission.

At the top end of the market—that is, for dwellings with more than 142 points and renting for over €700/month regardless of size—rents are decontrolled. This is the case for both social and private rented housing. The number of points necessary to achieve decontrol is normally revised annually in January – although this is now affected by controls to 2017. This regime was put in place in 1990 for new construction and in 1994 for existing dwellings, with the goal of gradually freeing rents as the proportion of decontrolled properties grew. The ‘free’ rented sector reached 5% by 2004, and the aim was that 25% would be deregulated in the following five years, but the target was dropped by the new government in 2007. Currently about 30% of private rented dwellings have decontrolled rents (Whitehead et al 2012). An annual government decree sets out the permitted increase in regulated rents, which since 2008 has been in line with inflation.

There are a great many rented dwellings with more than 142 points for which the landlords charge less than €700/month—even though they *could* charge as much as they like. The actual rent charged, rather than the number of points, determines whether the letting remains in the regulated sector. This anomaly comes about for two reasons: first, because some local markets in the Netherlands simply will not support higher rents; second, because housing associations are the dominant landlords. Their stock of ‘social’ housing competes directly with private rented housing. Much of it is of high quality and there is little or no stigma associated with living in social housing in the Netherlands. The housing associations see it as part of their social mission to keep rents low; they are also wealthy and do not need to maximise returns. This means that private landlords with properties renting at or somewhat above the cut-off point find it difficult to compete with housing associations as the latter charge much lower rents<sup>4</sup>. This is one reason that institutional landlords in particular have been divesting from the sector.

In some areas, though, market rents are much higher and there are still shortages, since the results of the points system do not necessarily correspond with market outcomes. Particularly in high-demand, high-cost areas, the system produces large gaps between regulated and free-market rents. This has led to the emergence of black markets with side payments and sub-letting by tenants paying regulated rents. To address these issues, in 2011 the system was modified to give extra points to dwellings in ten high-cost areas, so landlords could charge higher rents on new lettings. In these areas, dwellings worth less than €2900/m<sup>2</sup> (according to the national property valuation system) were allocated 15 extra points, while those worth more than €2900/m<sup>2</sup> were allocated an additional 25. This has taken significant numbers of units out of regulation on vacancy. Recently the Dutch government agreed that the €700 limit would be maintained for three years with the intention of incentivising the transfer of properties to the deregulated sector.

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3 The main determinant is size—one point is given for each square metre of internal space. Other factors include for example having its own boiler (3 points, or 5 for a condensing boiler), floor insulation 2 points, bath 6 points, etc. See Fitzsimons 2013 pp 23-26.

4 In 2010 housing associations owned 1.06m dwellings with over 142 points, but on only 87,600 was the rent more than the cut-off (Fitzsimons 2013 p. 96).

In 2013 and 2014, landlords were permitted to impose larger rent increases on high-income households. Those earning more than €43,000 per annum could see rents increase by 6.5%. These higher rent increases were initially coupled with a temporary tax on all landlords owning more than ten dwellings with regulated rents, but the two policies have now been separated. Recently however absolute-value rent controls were imposed for two years

Leases are generally indefinite, although the Dutch parliament is currently considering proposals to introduce fixed-term tenancies of two or five years in special cases. Leases bind the new landlord if the property is sold. Tenants can be evicted only if the tenant has not fulfilled his or her obligations, or if the landlord wants to use the property themselves. The period of notice is between three and six months, depending on how long the tenant has lived in the property.

## ***San Francisco***

Most San Francisco homes are rented (about 60%, according to the 2010 US Census). San Francisco introduced rent control in 1979 for dwellings in multi-unit properties built before 1979, and since then extended it to pre-1996 tenancies in single-family homes. The regulations cover the majority of the city's rental property. Rent control does not apply to post-1996 tenancies in single-family homes, which includes condominiums (apartments in individual ownership). Thus if a multi-unit building is in single ownership the apartments are rent-controlled, but if the units are individually owned (as is typical in the UK) then rent control does not apply.

There is no restriction on the initial rent on a new lease. Tenancies are de facto indefinite, with the tenancy ending only when the tenant decides to move or the landlord obtains a court order under 15 specified grounds for eviction. Within the lease landlords can only raise the rent by a set amount each year. This amount is determined annually by the San Francisco Rent Board and is meant to be 60% of CPI inflation in the local area. Permitted rent increases have been consistently low; for the year to 28 February 2015 the allowed increase was 1%, and in the preceding 20 years the permitted increase exceeded 2.5% only three times. Because the permitted increase is below inflation, real rents in rent-controlled units fall throughout the tenancy.

Landlords can request permission to increase rents because of increased costs or to pay off investments in capital improvements. In the latter case the rent increase applies only until the investment is paid off (San Francisco Tenants Union 2014). Rent control is also used punitively to enforce housing standards: if an otherwise non-rent-controlled unit has housing code violations that remain uncorrected for 60 days or more, the unit becomes subject to rent control.

Rent control applies to multi-unit buildings in single ownership, which covers much of San Francisco's housing stock. Landlords cannot normally ask tenants to leave without cause, but under California's 1986 'Ellis Act', landlords can evict all the tenants from a building in order to remove it from the rental market. If they do so, they must pay each evicted tenant compensation ranging from \$5,000 to \$16,000. The vacant properties resulting from Ellis Act evictions are normally sold into owner-occupation; if the units are re-rented then for the first five years the rent cannot exceed the rent that the evicted tenant was paying, and the evicted tenant must be given first refusal.

San Francisco has long been one of the country's most expensive residential markets, and the strong Silicon Valley economy has fuelled a post-crisis upturn in prices for owner-occupied housing. Landlords who do sell can potentially make large profits, and in recent years there has been an increase in Ellis Act evictions, as landlords sell to developers. In absolute terms though the numbers are small; there were 216 Ellis Act evictions in 2014, and 309 in the previous year. The press has recently reported that some 'Ellised' buildings are now used for vacation rentals through online matching services such as VRBO and AirBnB.

Rent levels and the rights and responsibilities of tenants and landlords are long-running local political issues, with vocal and well-funded advocacy groups on both sides. The city has become a popular residential location for well-educated, well-paid Silicon Valley employees who reverse commute. This has generated strong pressures to incentivise low-income/low-rent tenants to leave, and there have recently been protests against the gentrifying effects of commuters who ride the ‘Google buses’ provided by high-tech employers clustered to the south of the city.

## *Conclusions*

The evidence from other countries suggests that

- i) many countries have stronger regulations than in the UK but also have larger healthy private rented sectors with both willing landlords and willing tenants;
- ii) however this depends on history, culture, institutions and particularly on the attributes of other tenures;
- iii) it is not so much the strength of existing regulation (which the market has already taken into account) but rather potential and actual changes in that regulation and uncertainties about future changes which impacts on landlord and tenant behaviour;
- iv) currently there is pressure to increase regulation in a number of countries/cities where housing market pressures are rising;
- v) in these conditions increases in regulation tend to help existing tenants at the expense of those looking for accommodation;
- vi) the degree to which landlords can avoid the negative impacts of regulatory change depends mainly on their capacity to transfer into other markets, notably owner-occupation;
- vii) uncertainties around future regulation make landlords more risk-averse and therefore can result lower supply and a greater propensity to concentrate on leasing to easier tenants.

## 9. International experience: taxation of private landlords

In the UK, the activities of private landlords are treated and taxed as businesses (rather than investments) and property is in the main treated as a perpetual asset. Landlords, like other business owners, are permitted to deduct those expenditures related to the operation of their business from their business income. In the case of landlords as well as other types of business this includes interest payments on loans (but not repayments of principal). Landlords of fully furnished accommodation are also currently allowed to deduct 10% of the net rent to cover ‘wear and tear’—essentially a form of depreciation. In practice this allowance is probably only available to a minority of landlords. According to one recent survey, some 30% of landlords let their properties furnished, 8% let them part-furnished and 43% let them unfurnished. The remainder—about 19%—had a mixture of furnished and unfurnished lets (NLA 2012). The figures from the latest Private Landlords Survey, based on dwellings rather than landlords, were similar: 59% of units were let unfurnished, 15% partly furnished, and 26% fully furnished (DCLG 2010).

In general private landlords have been taxed as other businesses and receive no special subsidies. However while those engaged in ‘trade’ are permitted to offset trading losses against income from other sources, landlords can only set losses against rental income in the current year, or carry them forward. The tax rate payable depends on whether the landlord is an individual or a company. Individuals pay income tax at their marginal rate (20, 40 or 45%) while since 1 April 2015 companies pay corporation tax at a flat 20%. Individuals pay tax on capital gains at 18 or 28% after deduction of any available annual tax-free allowance. Companies do not have an annual tax-free allowance but can claim indexation to reduce chargeable gains (Cave 2015).

The UK was not unusual in its tax treatment of mortgage interest—in fact across Europe landlords can deduct these payments from taxable income as an investment good. Finland is the only exception we know of (Scanlon & Kochan 2011). But in most countries, other elements of the tax code are more favourable to landlords. In particular, many countries permit landlords to depreciate their rental investments (either the entire value or the cost of the building only). This is not permitted in the UK except for the wear-and-tear allowance. Similarly, many countries permit so-called ‘negative gearing’, where landlords can offset losses from residential rental properties against income from other sources. Again, this is not a feature of the UK system. Finally, some countries have lower taxes on rental income than on other business income.

Table 5, below, summarises income-tax treatment of landlords in 15 developed countries, including the USA and Australia. The pink cells indicate less-favourable tax treatment than in the UK, while the blue cells show where countries treat landlords more favourably. The table gives a clear indication that the UK income-tax system is already less favourable to landlords than that of many countries, especially in its treatment of depreciation and negative gearing.

Similarly, many countries provide targeted subsidies (low-interest loans or grants) to private landlords. The goal is normally to incentivise new construction (usually for low-income households) or energy-saving modernisation. In the UK some local authorities do provide refurbishment subsidies, but they are not available nationwide. Depending on their specific characteristics, these subsidies and the tax provisions discussed above act as incentives for landlords to invest in the sector, to provide housing of good quality and/or for specific target groups.

In July 2015 George Osborne announced that the income-tax treatment of buy-to-let landlords and those letting furnished accommodation would be made less favourable in two important ways. First,

from 2017 landlords will no longer be permitted to deduct mortgage interest payments from their rental income before calculating tax due; instead they will be able to take a credit of 20% of mortgage interest paid (equivalent to company landlords). Most basic-rate taxpayers will see no change in the amount of income tax due, but individuals who have buy-to-let mortgages and pay higher or additional-rate tax (that is, those with taxable incomes of over £40,000 per annum from all sources) will see their tax bills increase.

The second change announced was the removal of the provision that permitted landlords renting furnished accommodation to deduct 10% of gross rental income to cover the cost of replacing furnishings lost to 'wear and tear', regardless of whether they actually did replace any items in the home. From April 2016 only actual expenditure can be set against rental income. Later the system will be replaced by a tax relief regime. Those landlords who regularly invest the equivalent amount in maintaining the furnishings of their property will be no worse off, but a significant proportion of landlords renting furnished accommodation will face increased tax bills.

The likely impact of these changes can only be guessed at this stage. They depend on the proportions of buy-to-let landlords with larger mortgages who are subject to higher-rate tax and on the difference between actual and currently assumed wear and tear expenditure in furnished accommodation—as well as on alternative investment opportunities.

The most likely outcome is that there will be some increase in expenditure on furnishings but underlying pressures will be to move from furnished to unfurnished provision. Secondly there will be some incentive for those buy-to-let investors affected (and not all will be) to sell their properties. The government seems to assume that landlords will sell to owner-occupiers, but there is no requirement for them to do so. The scale of this impact depends not just on the health of the owner-occupied market but on yields on alternative investments where former landlords could put the cash realised.

Importantly, UK landlords are generally treated less generously than landlords in other countries, especially countries where the private rented sector provides homes for a large proportion of the population. The changes made in the July budget reinforce the idea that private renting in the UK in tax terms should be treated more like owner-occupation (except with respect to capital gains tax) than as a business contributing to the health of the housing market and the macro-economy.

**Table 5: Income tax treatment of residential rental income in various countries**

Colour key:

Tax treatment similar to UK	
Landlords treated more favourably than in UK	
Landlords treated less favourably than in UK	

	<i>Mortgage interest deductible</i>	<i>Lower tax on rental income</i>	<i>Costs deductible</i>	<i>Depreciation allowance</i>	<i>Rental losses offset against other types of income</i>
<b>UK</b>	•	*	•	• *** (wear-and-tear furnished only)	
<b>Austria</b>	•		•	• accelerated depreciation for low-rent units	
<b>Australia</b>	•		•	• new properties only	•
<b>Belgium</b>	•	•	•	•	
<b>Denmark</b>	•	• institutions only	•		•
<b>Finland</b>		•	•	• for institutions	•
<b>France</b>	• but cannot lead to loss		•		• up to limit
<b>Germany</b>	•		•	•	•
<b>Ireland</b>	• 75%		•	•	
<b>Netherlands</b>	<b>Business</b>	•	•	•	•
	<b>non-business</b>		**		
<b>Norway</b>	•	• if renting part of your home or short-term	•		•
<b>Spain</b>	•	•	•		•
<b>Sweden</b>	•		•	•	
<b>Switzerland</b>	•		•	•	•
<b>USA</b>	•		•	•	• with limits

\*No 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: From Kochan & Scanlon 2011 Table 4, updated

## 10. Implications of international experience

We can learn some lessons about longer tenancies and rent stabilisation in particular from European experience, while US examples tell us something about the consequences of rent control. This brief review of international practice highlights three things. First, there has been increasing pressure for control on *initial* rents in many cities or countries where only rent *increases* have hitherto been limited. This is in response to rapid increases in rents for new leases often concentrated in particular cities. New regulations have imposed such limits in several German cities and in Paris (soon to be implemented) and are under discussion in Dublin. On the other hand in the Netherlands the government is trying to encourage landlords to increase rents on some of the stock, so as to bring the units out of the regulated sector. This has much to do with the market dominance of Dutch housing associations—which brings us to the second point.

This is that the effects of regulation of the PRS in any particular place are very strongly conditioned by the overall legal, fiscal and cultural environment. The discussions of international examples often focus only on particular provisions—for example, pointing out that Germany, with a very large private rented sector, also has controls on the amount that rents can be increased within a tenancy. But cherry-picked comparisons can be misleading, as they often leave out crucial explanatory factors that may not even be directly related to housing policy.

Third, the UK is perhaps unusual in that it is simple and frictionless to transfer a dwelling between owner-occupation and the private rented sector and vice versa, both because there are no planning controls related to tenure of private housing and because of short-term leases. This gives us a flexible and responsive housing sector, and means it is easy to grow the PRS from existing stock when investors perceive benefits. The UK's experience in more than doubling the size of the PRS over just 20 years is almost without parallel internationally. Equally, however, the sector could shrink very rapidly if the incentives were to change. It is indeed true that there are other countries or cities where private renting houses a larger proportion of households than here, *and* is much more highly regulated. This suggests that there is no necessary contradiction between a large, well-functioning PRS and a high degree of regulation—but it doesn't tell us *why* it works elsewhere.

In fact, many things set us apart from places where tighter regulation coexists with a bigger rented sector, not just the degree of regulation. First, many have significantly greater barriers to transfer out of the sector—see for example San Francisco where the Ellis Act must be invoked and the sale of PRS dwellings is highly politicised, or Germany where in principle dwellings can transfer between PRS and owner-occupation but where new owners must honour the leases of sitting tenants. Also, most countries that do regulate rents also try to encourage landlords to stay in the sector by providing favourable tax treatment and/or subsidies.

All changes in regulation which negatively impact on rents and yields and on risk and confidence can be expected to reduce supply and make it more difficult to for new tenants to find the accommodation they want. To the extent that a new system increases certainties around rates of return and terms and conditions it could help to stabilise the market and make it a better investment opportunity. Some of the proposals have some potential in this direction. However as already stressed all systems depend on the specifics of institutional and regulatory arrangements as well as the choices open to landlords and tenants.

### *In conclusion*

Increases in regulation are being introduced or contemplated in a number of major cities in Europe—notably Berlin and Paris—as well as in London. These initiatives reflect growing housing market

pressures, rising rents and difficulties faced by many working households to achieve affordable housing.

International experience suggests that it is not so much existing regulation that impacts on landlord and tenant behaviour but rather changes in that regulation and uncertainties about future changes. It also suggests that most countries have tax regimes that are more generous to landlords than the UK, especially given the changes to be introduced in the next few years.

London needs more good-quality private rented housing and more landlords who are happy to provide stability with respect to rents and length of tenancy. We hope that whoever is elected Mayor can take positive messages from this report.

## Annex 1: The current regulatory framework in England

*Tenure security:* Default tenancy is Assured Shorthold Tenancy (AST). Normally lasts 6 or 12 months, and landlord has right to possession with two months' notice at the end of the term, or any time thereafter. If the tenant remains and no new lease is signed, the tenancy becomes a periodic or month-to-month tenancy at the same rent and on the same terms as the AST.

*Rent regulation:* For leases agreed after 15 January 1989 there is no regulation of initial rents or of rent increases within a tenancy. There is some *de facto* regulation of rents where tenants receive housing benefit or local housing allowance, as support is limited to the bottom 30% of the market and there are absolute caps which bite in some areas, notably parts of London.

*Procedure for possession:* For Assured Shorthold Tenancies (most tenancies that commenced from 28 February 1997), landlords may use a Section 21 notice at the end of the lease term or anytime thereafter. This gives them the right to possession with two months' written notice, without having to give a reason; it cannot be used in cases where the landlord seeks to recuperate unpaid rent. If the tenant does not leave when required to do so the landlord may seek 'accelerated possession.' The court makes a decision on the basis of papers (no hearing) and can require the tenant to leave within 14 days, which can be extended to a maximum of 42 days in the case of exceptional hardship. If the tenants still do not leave the landlord can apply for a warrant for possession, and bailiffs will evict them. The procedure is much quicker than the time required for a Section 8 eviction (below).

In cases where the landlord is seeking possession for non-payment of rent or anti-social behaviour, a Section 8 notice may be used. This is a court procedure where the landlord must demonstrate that the tenant is in breach of contract. The Housing Act 1988 sets out eight mandatory grounds for eviction and ten discretionary ones.

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