the future of the private rented sector

Edited by Peter Bill, Paul Hackett and Catherine Glossop

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Preface

Dermot Finch, Director of the Centre for Cities, and
Wilf Stevenson, Director of the Smith Institute

The Smith Institute and the Centre for Cities have been actively involved in the housing debate, hosting seminars and meetings with government and key stakeholders and publishing influential research and thought leadership papers. These two leading think tanks have joined forces to sponsor this timely monograph on the future of the private rented housing sector.

The government's house-building targets are being driven by two clear policy ambitions: to increase owner-occupation and provide a larger quantity of affordable housing. The role the private rented sector can play, however, has been largely overlooked. This situation is now starting to change, and the policy spotlight is more firmly on what the private rented sector can offer over the medium to long term.

The sector has developed rapidly in recent years, but a lack of professionalism and poor standards of management in some segments of the market have prevented it from reaching its full potential. The government has pledged to improve the sector for both landlords and tenants, and is seeking views on how this might be achieved against the backdrop of the credit crunch and an increasingly fragile market. Independent reviews of the private rented sector (and the management and conditions of people living in houses in multiple occupation) are under way, with the final reports due this autumn.

This monograph of essays, authored by key experts in the field, is intended to inform the government-initiated review and policy-making process. The focus is on addressing the major challenges facing both small and large landlords, and on what can be done to bring new, affordable private rented properties onto the market. The authors examine the important underlying market trends and take a critical look at the way the sector is funded, including the prospects for emerging subsectors (such as buy-to-let and student housing). Planning, licensing and regulatory issues are considered, and there are some complex issues here to be addressed – not least balancing the rights and responsibilities of landlords and tenants.

Whatever their views on what needs to be done, all authors share a commitment to expanding the private rented sector and raising quality standards across the country. With the Homes & Communities Agency now in set-up mode, and the appointment of

Caroline Flint as the new Housing Minister, it is timely to influence this emerging agenda.

Recommendations range from the development of investment vehicles to fiscal incentives and tighter regulation. All parties have a role to play – Whitehall, cities, developers and investors. First and foremost, however, a future vision and strategy for the sector must be created. Unless all parties agree on the direction of travel, a stronger private rented sector will be hard to achieve.

The Smith Institute and the Centre for Cities thank Peter Bill, Paul Hackett and Catherine Glossop for editing this collection of essays, and gratefully acknowledge the support of the UNITE Group towards this publication and the associated seminar.

Introduction
Peter Bill, Editor of Estates Gazette

There is growing recognition that the private rented sector can contribute to the supply of new homes. But how? Six of the eight essays in this monograph reach the same obvious conclusion: the government must make it more worthwhile than it is right now for someone to supply them. Unless fiscal and planning policies are changed, there will be no substantial change in the numbers of homes for rent.

In July 2007 the government published a green paper consulting on the aim of building 70,000 new homes for lower-income households by 2010. In the same month the Law Commission published a highly detailed plan for the regulation of the rented sector. In December the Department for Communities & Local Government announced a review of the private rented sector, which will report in October 2008.

This new focus on the sector is welcomed by all the essayists. It was, in part, the stimulus for this monograph. But the prime aim is to supply ideas that will stimulate a substantial increase in the stock of rented homes to help meet the England-wide target of building 240,000 new homes each year by 2016 (compared with around 187,000 last year, of which 158,000 related to private-sector activity).

Right now the supply of new homes for sale is falling. Government targets are in jeopardy, with the number of new homes continuing to fall behind the rate of household growth (the number of new households created each year is projected to rise to 223,000 by 2026). But supply plans currently include only three broad options: build to sell; the construction of "affordable" homes by registered social landlords (29,000 completions last year); and nascent plans to allow councils to set up joint-venture housing companies. There is no co-ordinated policy to drive up the number of rented homes.

Real estate investment trusts have failed to encourage the building of homes for rent, nor have they helped professionalise the rented sector. Both these aims were central to the policy introduced after years of debate in January 2007. So what now?

The opening essay by Catherine Glossop from the Centre for Cities makes it plain that demand for rented homes is high, and likely to remain so until at least 2021, when there could be 3.6 million renters in the UK, compared with 2.4 million in 2001. She then raises the two refrains echoed by five other writers: new fiscal and planning incentives are necessary to stimulate supply.

In the second essay, Ricky Taylor of the National Housing & Planning Advice Unit charts the impact on house prices of the biggest accidental boost to the rental market for over a century: the buy-to-let market. In 10 years the number of buy-to-let mortgages went from almost none to 991,000. Despite this, although buy-to-let mortgage lending is found to have increased house prices, other demographic and economic factors have been the real contenders.

How do you create additional capacity in the private rented sector? Adam Sampson and Caroline Davey of Shelter suggests that registered social landlords could be allowed to enter the private sector in a much bigger way – and that in planning new communities, a "certain proportion" of the stock be reserved for private renting.

This leads to the central point made by Mark Long of Invista. He points out that the UK has by far the lowest level of institutional investment in Europe in private rented housing. If there were a separate use class or a licensing scheme, that would change.

The separate use class idea would oblige a council to give permission only for homes rented for perhaps 15 years before they could be sold. The licence idea relies upon a section 106 agreement drawn up with the local authority that stipulates a certain proportion of the development should contain homes that have to be rented out for at least 15-20 years. Long also calls for a level playing field on both VAT and stamp duty payments. Today the individual investor has an advantage over the corporate, he suggests.

Liz Peace of the British Property Federation adds one further fiscal suggestion: owners should be allowed 100% capital allowances on their tax bills to offset the cost of refurbishing or repairing homes for rent, and VAT for doing the work should be cut to 5%. The chief executive of the BPF also calls for the rules on real estate investment trusts to be altered to allow for REITs that are not listed on the stock exchange. This, she says, will bring about the existence of residential REITs and so draw money in from pension and life funds.

The chief executive of student housing supplier the UNITE Group, Mark Allan, gives a glimpse of what can work. The company has established a £1 billion fund that holds £850 million of assets and now has £370 million of outside equity. Allan calls for changes to the use class system – or an extension of the planning regulations to cover rented accommodation.

Allan also makes the point that the sector suffers from negative stereotyping. This draws in the other two essays, which concentrate on regulation.

Ian Potter of the Association of Residential Letting Agents says the government should extend the scope of its licensing plans for estate agents who sell homes to those who plan to let them out. Meanwhile Lord Richard Best calls for the current Housing & Regeneration Bill to be extended to cover the private rented sector. The former director of the Joseph Rowntree Foundation says that far from frightening away investors, regulation would give them the consistency and clarity they need. "It seems astonishing", he concludes, "that the private rented sector – a multi-million-pound industry that profoundly affects the lives of millions of consumers – has no regulator, no ombudsman, no redress scheme." He says this could all be fixed by an enabling clause in the new bill.

The private rented sector: a brief overview[1]

In 1910, around nine out of 10 households rented from private landlords. By 1992, the figure was less than one in 10. Since then, the sector has expanded. It now houses some 11% of households, equating to some 2.33 million dwellings.

The number of privately rented dwellings differs markedly in different areas. In London, 17% of households rent privately. In each of the other English regions, the percentage is around 11%.

The supply side of the private rented sector is dominated by small-scale and part-time landlords. In 2003, private individuals owned some 67% of private rented dwellings in England. It is estimated that there are 700,000 private landlords in England. The median number of lettings per landlord was between two and four in 2003, and 33% of landlords owned only one property.

A fifth of privately rented dwellings have been acquired by the landlord since 1999. In the period from the end of 1999 to the end of 2005 the number of outstanding buy-to-let mortgages increased by 673,200 to 701,900. Overall, only a third of properties in the sector have an outstanding loan or mortgage attached to them.

1 Grateful acknowledgement must be given to the Law Commission for the following information on the private rented sector. This is a summary of the main statistics and issues drawn from *Ensuring Responsible Letting*, published in June 2007. Consultation on the findings, which included the view that the sector needed a regulator, was concluded in October 2007.

Almost a third of the properties in the sector were not originally acquired for letting. Nearly one in five privately rented dwellings were once the landlord's own residence, while 10% of dwellings are owned by landlords who expect that either they or their relatives will reside in them in the future.

Private renting is predominantly a tenure of the young. Two-thirds of those in private rented housing are economically active, working either full- or part-time. This is a similar proportion to those in owner-occupation, but double the proportion in social housing. Ethnic-minority households are more likely to be living in private rented housing than are white households.

While 10% of white household reference persons rent privately, 21% of those from minority communities live in the sector. All minority communities are over-represented in private renting, with the exception of those of black-Caribbean origin.

In 2005, 9% of private renters and 10% of social renters had a gross income, including that of any partner, of less than £5,000 a year. 44% of private renters and 73% of social renters had a gross income of less than £15,000 a year.

While only 6% of those living in social housing had an annual income of more than £30,000, a quarter of those renting privately did. This includes the 8% of private renters with an income above £50,000. The income profile of private renters is therefore significantly different from that of social renters.

While the private rented sector houses a similar proportion of the very poorest, poverty is not nearly as concentrated as in the social housing sector. Indeed, parts of the private rented sector accommodate the wealthiest.

The rates of return on investment available to landlords, and their source, in either capital growth or revenue, differ between different sectors of the market. Gross and net rates of return tend to be highest in poorer-quality sectors of the market

Chapter 1

Making the case for a stronger private rented sector

Catherine Glossop, Analyst at the Centre for Cities

Making the case for a stronger private rented sector

Housing affordability and supply constraints: is there a way out?

The recent All Party Urban Development Group report *Delivering Urban Homes* made it clear that the government's target to build 3 million new homes in England by 2020 is unlikely to be met unless the private rented sector is given a bigger role to play.[1] Last year housing supply grew at a rate of only 172,000 units, and completion rates are expected to drop further due to growing macroeconomic uncertainty. Recent analysis by the National Housing & Planning Advice Unit shows that, even if we can meet the target build rate of 240,000 new homes per year, affordability is still set to worsen significantly.[2]

The government's house-building targets are being driven by two clear policy ambitions: to increase owner-occupation and provide a greater quantity of affordable housing. While these are worthwhile objectives, we are now at risk of creating an unbalanced dual-tenure housing market that fails to address the housing needs of those who cannot access either. The lack of any clear government strategy for the private rented sector has further diverted attention from its potential. This chapter aims to address this policy imbalance.

An expanded and improved private rented sector can bring greater market stability, better meet the affordable housing needs of different groups and support labour market flexibility. For this to be achieved, however, the sector will need stronger ministerial backing, the strategic engagement of cities and an injection of institutional investment.

Home ownership and market instability

The national drive for owner-occupation has been supported by a range of measures over the past three decades, most notably fiscal favouritism (including tax incentives) and the widespread selling off of public-sector housing at a discount. The result has been sharp increases in demand, without a corresponding increase in supply. This has contributed to the house price volatility and market instability we are seeing today.

Housing is the single biggest repository for wealth in the UK, with more than 50% of national wealth tied up in it.[3] This is inherently risky, as reflected in the recent rise in

1 All Party Urban Development Group *Delivering Urban Homes: The Role of the Public & Private Sector* (2008)
2 National Housing & Planning Advice Unit *Affordability Matters* (2007)
3 Total household financial debt has more than doubled over the past decade to £1.4 trillion. The value of housing assets underpinning this debt has increased by more than 150% since 1997, and is now estimated to be worth £3.7 trillion. For further detail see: HM Treasury *The UK Economy: Analysis of Long-term Performance & Strategic Challenges* (2008)

housing repossessions.[4] Instead of renting until households can purchase with some equity, the rush into ownership has left young, middle-income households more exposed to rising mortgage costs and potential house price falls. Policy attempts to increase home ownership among low-income groups are of most concern. Pushing home ownership at the margins risks encouraging home purchase by those who have more to lose than to gain by doing so, particularly in the current economic climate.

House price volatility has important implications for city competitiveness. High house prices are passed on in terms of higher wages and business costs, making cities less attractive investment prospects.[5] Local businesses typically cite the lack of affordable and suitable accommodation as a key reason for recruitment and retention problems.[6] This also contributes to skills shortages in the public sector, which in the case of key workers may impose high social costs.[7]

This is much less the case in many Northern European countries, where private rentals constitute a higher proportion of the housing stock and help maintain more stable housing markets – such as in Switzerland and Germany, where approximately two-thirds and half (respectively) of all households rent. In sharp contrast, the private rented sector in England accounts for only 11% of housing supply, with privately rented homes on the open market accounting for just 8%.[8]

A heterogeneous tenure: meeting the diverse housing needs of cities

The private rented sector in the UK may be small, but demand is strong and growing. According to the Investment Property Forum, the UK has 25% more unmet demand for private rented accommodation than it does for buying homes.[9] Analysis by Hometrack suggests that by 2021 the UK could have just over 3.6 million renters, compared with just

4 During 2007, repossessions rose by 20% nationally. The Council of Mortgage Lenders has predicted a further 50% rise in repossessions for 2008.
5 Muellbauer, J "The Housing Market and the UK Economy: Problems and Opportunities" in Ermisch, J (ed) *Housing & the National Economy* (National Institute of Economic & Social Research, 1990)
6 In June 2007, 69% of respondents to the CBI London business survey cited cost, quality and lack of suitable housing as key barriers to recruitment and retention.
7 DTZ *Housing, Economic Development & Productivity: Literature Review* (2006)
8 While Britain has one of the highest rates of house price inflation in the Western world, house prices in Switzerland and Germany have remained relatively stable. See: Evans, A and Hartwich, O *Bigger Better Faster More: Why Some Countries Plan Better Than Others* (Policy Exchange, 2005). House price inflation can be a driver of prosperity in cities, but can also create instability and exacerbate inequality.
9 IPF *Large-scale Investor Opportunities in Residential Property: An Overview* (2007)

under 2.4 million in 2001.[10] At recent rates of house building, a fifth of new housing supply would need to be privately rented to accommodate this demand.

A significant part of this growth in demand has come from the increase in single-person households and rising numbers of cohabiting multi-person households. Substantial further growth is expected in both these household types. Demographic and social change is also resulting in higher rates of mobility, particularly for young professionals, who are forming households and taking on family commitments at a much later point in the life-cycle. This is reflected in the over-representation of people working in professional and higher technical occupations in the private rented sector, compared with other tenures.

In conjunction with its youthful age profile, this confirms the importance of the sector to the "young professionals' market".[11] For this group, the sector is increasingly a lifestyle choice. Many do not want the financial and maintenance responsibilities of home ownership. Accessing this sector enables them to live in better-quality accommodation, in a better area than if they were buying a home, and, critically, provides the flexibility to move easily for employment.

The low transaction costs of entry and exit have enabled the private rented sector to provide accommodation to a growing number of transient populations, not just young and mobile professionals, but contractors, migrant workers and newly forming households, such as young people leaving home and the UK's growing student population.[12] Expanding the rental market will offer these groups a much wider choice of accommodation and location, as well as greater flexibility for those who may not want to stay in an area long.

Perhaps most importantly, the sector is playing a growing role in meeting the needs of the "intermediate" market, providing the only option now available to households earning low to medium incomes; households which are not eligible for social housing but cannot afford to buy. This is reflected in the recent increase in the number of young people accessing private renting as house prices have increased, alongside a corresponding decrease in young owner-occupiers.[13]

10 Such figures are likely to be conservative given the difficulty in predicting migration, which has a significant impact on the sector.
11 Rhodes, D *The Modern Private Rented Sector* (Joseph Rowntree Foundation/Chartered Institute of Housing, 2006)
12 The private rented sector is the most ethnically diverse tenure, and the dominant tenure among migrants. Interim findings published by the Equality and Human Rights Commission and the Local Government Association found that 60% of new migrants to Britain in the past five years were living in private rented accommodation.
13 According to Hometrack Housing Intelligence, 75% of tenants in the private rented sector cannot afford to purchase a lower-quartile house nationally.

The sector also plays a growing residual role. With a diminishing social housing stock and increased pressure on remaining stock, private renting provides an important safety net for those in housing need, including accommodation for homeless people, asylum seekers, those in receipt of housing benefit and those who have been evicted from the social housing sector. Increasing the capacity of the private rented sector will be fundamental if we are to reduce the number of people who experience homelessness and take the pressure off social housing waiting lists.

What all of this shows is that the private rented sector is a highly responsive tenure that has adapted to the different demands cities have placed upon it over time.[14] The sector does not restrict access to any particular group, but provides homes for a wide range of households from a variety of social and economic backgrounds – ranging from some of the wealthiest groups in society to some of the most vulnerable. Most importantly, the sector provides a much-needed bridge between owner-occupation and affordable housing provision. In light of current credit constraints and unstable market conditions, demand from this "intermediate" segment will only increase.

A flexible tenure: supporting adaptable city economies

The responsiveness of the private rented sector has not only been crucial to meeting the diverse housing needs of different groups, it has also played an important role in supporting the economic needs of cities. City economies have changed considerably over the past few decades as labour markets become increasingly dynamic. Strong city economies need to be adaptable and a responsive private rented sector can help them to achieve this. In the context of a 21st-century economy, the flexibility of the private rented sector can be crucial, and possibly security of tenure matters less than in earlier job markets.

A city's natural rate of unemployment depends on the ease with which its citizens can move around to find jobs. Both social housing and owner-occupation are characterised by low levels of mobility, with owner-occupiers only slightly more mobile than local authority tenants.[15] By contrast, private renters have the highest levels of mobility, and migration rates for this tenure are increasing over time.

Much research has shown that high rates of home ownership can create a labour

14 Rhodes, op cit
15 DTZ, op cit

mobility trap, which in turn can result in higher rates of unemployment.[16] If jobs are scarcer in one city, it is likely that property prices will also drop. Homeowners will be less keen to sell and, with the decrease in property value, less able to move to areas of jobs growth. Large transaction costs, such as stamp duty, provide a further disincentive to move, discouraging workers from seeking employment outside their commuting area. A strategy for increasing the range and supply of private rented stock could play a strong role in encouraging people to move to where jobs are available, raising employment rates and tackling inequalities between cities.[17]

Rates of labour mobility in the UK are particularly low for those in lower-level occupations. This is partly due to the fact that less skilled workers face higher housing costs as a proportion of their overall income.[18] Creating a readier supply of affordable private rented accommodation for this group could tackle skills shortages and reduce rates of worklessness by promoting mobility. Other factors are clearly involved, but this demands closer attention – particularly in light of present policy attempts to expand shared-equity schemes, which risk increasing housing costs to near unaffordable levels for low-income groups.[19]

What is the problem with renting? The case for intervention

If there is such a strong case to be made for widening access to private renting, why has the market not developed of its own accord?

Much of the problem has been laid at the door of the small buy-to-let landlord. Overwhelmingly dominating the sector, many are involved as a sideline activity and face severe capacity and resource constraints. The result in some cases has been a lack of

16 Blanchflower, D "Trends in European Labour Markets and Preferences over Unemployment and Inflation", keynote address at Dresdner Kleinwort seminar on European labour markets and implications for inflation and policy, 2007. At http://www.dartmouth.edu/~blnchflr/papers/speeches/speech323.pdf; Di Tella, R and MacCulloch, R "The Consequences of Labour Market Flexibility" in *European Economic Review* vol 45, no 5 (2005), pp1,225-1,259; Oswald, A *The Housing Market & Europe's Unemployment: A Non-technical Paper*, University of Warwick working paper no 615 (1999)
17 Song, H *Policies to Increase Access to Home Ownership for Low-income Households*, working paper no 46 (Royal Institute of Technology, Stockholm, 2003). At: http://www.infra.kth.se/BYFA/publikationer/engelskaUppsatserOchRapporter/46.pdf
18 DTZ, op cit
19 The interlinkages between housing tenure, labour mobility and levels of employment are complex and multi-dimensional. Home ownership rates and house price variables alone do not account for low rates of mobility in the UK. Other factors are clearly involved, including skill levels, information asymmetries, and the presence of acquaintances or family ties (Quigley, 2003). For a critique of this premise, see Gregg, P, Machin, S and Manning, A *Mobility & Joblessness*, National Bureau for Economic Research working paper (NBER, 2001); Gordon, I "Housing and Labour Market Constraints on Migration across the North-South Divide" in Ermisch, J (ed) *Housing & the National Economy* (Brookfield, 1990), pp75-89

professionalism and poor management standards. This is turn has resulted in the development of the sector's long-standing image problem.

Increasingly associated with transient communities, fragmented ownership and absentee landlords, the tenure is perceived as one of last resort. Reports of insecure tenancies, poor-quality stock and overcrowding are commonplace particularly, but not exclusively, at the lower end of the market. This has proved most problematic in more deprived neighbourhoods. Poor standards of management can compound many of the other problems affecting these areas, increasing levels of dissatisfaction and driving more mobile households out of the area.

As buy-to-let landlords concentrate on maximising their income yields, in what is looking increasingly like a market downturn, management and quality standards could fall further. It is often argued that increasing institutional investment would help improve conditions. Institutional investors operate a different business model from the buy-to-let landlord. Achieving efficiencies through economies of scale, with an emphasis on stable, longer-term returns rather than capital growth, they are better placed to help to address management and quality issues, and will be less deterred by current market conditions. Levels of institutional investment in the UK, however, are some of the lowest in Europe. There are several reasons for this, most notably fiscal and planning constraints and the difficulty in drawing up effective ways to contract housing management.

Problems in the sector, however, are not restricted to image and management competencies alone. As the current crisis in buy-to-let shows, investors have increasingly lost touch with their market. This has led to homes being built in the wrong place and of the wrong type – such as the current oversupply of new-build city-centre apartments. The subsequent rise in empty properties has confused the fact that we are still facing a fundamental shortage of housing. If this problem is to be addressed, cities will need to engage with the private rented sector (developers, landlords and tenants), and adopt a more strategic approach – helping investors to know where the need is and for what type of product.

All of these problems can be overcome, but only if there is the political will. In the context of Gordon Brown's mantra of a "home-owning, asset-owning, wealth-owning democracy", the scope for manoeuvre has been limited. Nevertheless, there is some expectation that the mood may be changing, most notably with the government-commissioned review of the private rented sector soon to be published by Julie Rugg and David Rhodes from the Centre for Housing Policy at York University. If the private rented sector is to be expanded, however, this will require more than the announcement of yet another review.

Recommendations for the public and private sectors

This chapter has argued that an expanded and improved private rented sector can support labour mobility, meet the diverse housing needs of different groups and bring greater market stability. Most importantly, the sector provides a much-needed bridge between owner-occupation and affordable housing provision. Given current credit constraints, demand from this "intermediate" segment will only increase.

This is not to argue against the benefits of home ownership. Home ownership and the private rented sector are complementary.[20] The objective is not to replace one tenure with another, but to expand overall housing supply, choice and quality.

With macroeconomic conditions further weakening the capacity of small landlords, any significant expansion in private rented stock will depend on an injection of institutional investment. For this to be encouraged, however, a more level playing field will need to be created. Whitehall has several policy levers available:

- fiscal incentives – such as modifications to stamp duty and VAT. Institutional investors are penalised in terms of both higher levels of stamp duty than individual investors, due to larger lot sizes, and their inability to reclaim VAT on repairs. Stamp duty reductions may be unlikely in the current fiscal climate, but should be considered over the medium to long term;
- planning incentives – the UK planning system is largely focused on the affordable and owner-occupied market. The private rented sector, for example, is not differentiated from owner-occupation when considering social housing provision through section 106.[21] Options could therefore include the creation of a new planning use class for residential property or the introduction of a licensing scheme that reduces the social housing component with the property remaining in the rental market for a set period of time (this presents a more viable option in the immediate term); and
- regulatory reform – introducing a reasonable measure of regulation to ensure minimum standards, with stronger measures in place so that these are adhered to.

20 A stable housing market requires a strong private rented sector to go hand-in-hand with owner-occupation.
21 Investors in new rental accommodation are required to invest higher sums of capital, as their money is tied up in the long term, relative to traditional house builders who sell immediately upon completion. The argument is that rented accommodation should therefore not attract the same section 106 requirements – for further detail, see: *Overcoming Barriers to Institutional Investment in Residential Property*, working paper 29 (GLA Economics, 2008)

Cities in turn will need to adopt a more proactive stance and make better use of their strategic planning tools – both to shape local markets and to raise quality standards. The onus must be on all cities to develop a better understanding of the rental markets in their area, and deliver a housing growth plan that will better align supply with demand.

Given the scale and complexity of the task, the support of the Homes & Communities Agency will be crucial. Local authorities with skills and capacity issues may need particular support if they are to attract the right type of investment and work better with what is already there. The remit of the agency must take account of the role played by all housing tenures. Focusing only on owner-occupation and affordable housing provision will not help cities respond to their needs in a fragile market.

From the perspective of the private sector, the market downturn represents both an opportunity and a challenge – an opportunity for investors to take advantage of falling property prices and increasing rents,[22] while delivering a more diverse range of housing supply; and a challenge to ensure that quality and management standards are not overlooked in a bid to maximise returns. Investors must recognise that in the long run, adopting the latter approach will benefit neither the sector nor their profit margins.

All of this, however, will depend on all parties agreeing on the direction of travel. Unless an overarching vision and strategy for the sector is created and agreed, a stronger private rental offer will be hard to achieve.

22 Hometrack Housing Intelligence reveals rental growth in cities, based on a comparison of weekly rents between the first quarter of 2007 and the first quarter of 2008.

Chapter 2

Worsening affordability and the buy-to-let mortgage sector

Ricky Taylor, Principal Research Adviser at the National Housing &
Planning Advice Unit

Worsening affordability and the buy-to-let mortgage sector

The popular conception is that the rapid growth in buy-to-let investment has been a key component of recent house price increases in the UK housing market.[1] There is, however, little published empirical research on the impact of this sub-market on housing affordability. Drawing on recent research conducted by the National Housing & Planning Advice Unit (NHPAU), this chapter aims to help fill the gap.

This chapter finds that, although buy-to-let mortgage lending has increased house prices, other demographic and economic factors have been more significant. Housing affordability is projected to worsen. In an increasingly constrained market, the private rented sector provides an important alternative to owner-occupation, and demand for this tenure is expected to increase.

The link between buy-to-let and house prices

The last decade has seen rapid growth in buy-to-let properties. Much of this growth has been due to developments in the buy-to-let mortgage market, which has given investors the means to borrow easily and at competitive rates. From their introduction in July 1996, following an initiative launched by the Association of Residential Letting Agents (ARLA), buy-to-let mortgages increased to over 991,600 by the end of September 2007, with a value of over £116 billion.[2]

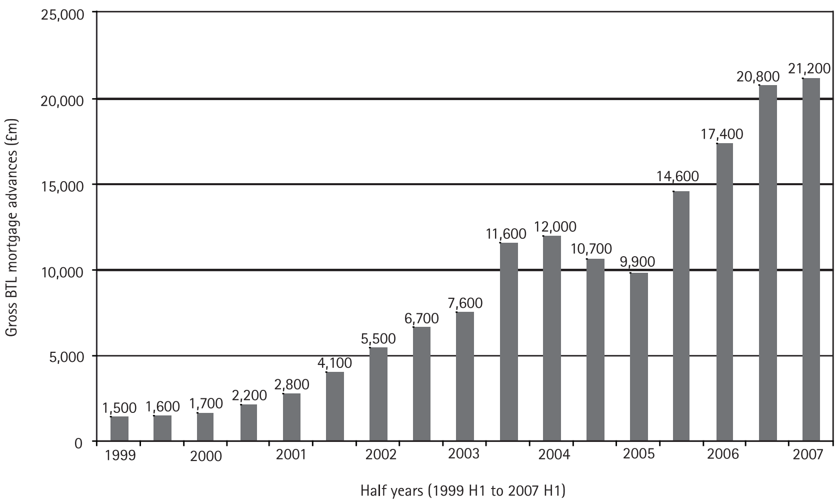
These record levels of buy-to-let investment are believed to have raised demand and, with supply more or less fixed in the short term, pushed up house prices. Others also contend that this large-scale investment activity has led to the break in the relationship between house prices and average earnings.[3] In response to this, the NHPAU developed a model to examine the impact of buy-to-let on UK house prices.[4]

1 Buy-to-let is characterised by private investors who purchase residential property using mortgages in order to rent out accommodation to tenants. The property is an investment asset on which they can both earn a rental return and achieve longer-term capital gains as house prices rise.
2 Council of Mortgage Lenders statistics from 2007 – http://www.cml.org.uk/cml/statistics
3 Sprigings, N, Nevin, B and Leather, P "Semi-detached Housing Market Theory for Sale: Suit First-time Buyer or Investor", paper presented to the Housing Studies Association Conference, 19-20 April 2006.
At: http://www.research.salford.ac.uk/surf/documents/sprigings06.pdf
4 The National Housing & Planning Advice Unit was established in response to the pressing issue of housing affordability highlighted by Kate Barker's review of housing supply in 2004. It is a non-departmental public body, sponsored by the Department for Communities & Local Government. A key remit of the unit is to develop a robust evidence base and provide independent advice on housing affordability to the government, regional assemblies and stakeholders.

Evaluating the impact of buy-to-let on house prices

The findings from the NHPAU's house price model are presented here. The model attempts to simulate the impact of buy-to-let on UK house prices following their introduction in the third quarter of 1996. The model accurately estimated house prices between 1994 Q2 and 2007 Q2 and is based on the factors identified by previous research as important determinants of house price movements.

Figure 1: Buy-to-let gross mortgage advances



Source: Council of Mortgage Lenders

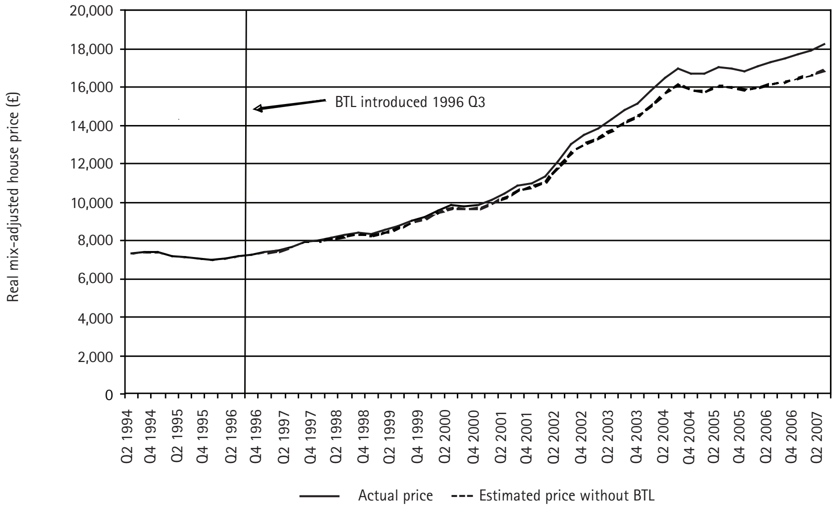
The following factors were used by the model to explain changes in UK house prices between 1994 Q2 and 2007 Q2:

- the average mortgage interest rate;
- real household disposable income per capita;
- the repossession rate;
- real value of mortgage advances (including buy-to-let);
- stock of dwellings;
- number of households; and
- housing user cost of capital (a measure of the cost of home ownership less the capital gain).

The model was used to estimate what house prices would have been had there been no buy-to-let mortgage lending. This is regarded as the counterfactual house price and is compared with actual house prices. The difference is assumed to be the inflationary effect of buy-to-let on house prices. This can be seen in figure 2.

Drawing on the last period for which a comparison can be made, during 2007 Q2 the actual adjusted house price was £183,000 and the counterfactual house price was estimated to be £169,000. This implies that buy-to-let lending had increased prices by up to £13,000 (or 7%) over and above what they would otherwise have been. These estimates represent an upper bound on the buy-to-let impact, because the counterfactual (that is, what house prices would have been without buy-to-let mortgage lending) assumes that non-buy-to-let advances would have remained unchanged. In reality, if buy-to-let mortgages had not existed, it is likely that there would have been some upward shift in non-buy-to-let mortgage advances.

Figure 2: Actual mix-adjusted house prices and the estimated house price if there had been no buy-to-let mortgage lending (1994 Q2 to 2007 Q2)



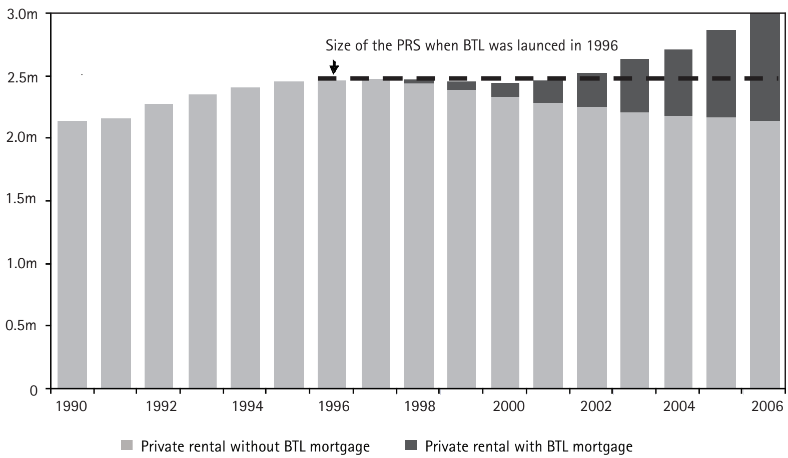
The model shows that, between 1996 Q3 and 2007 Q2, the overall impact of buy-to-let on house prices has been relatively modest. This illustrates the point made by others that house price movements can largely be explained by fundamental economic and demographic factors. The model used in this paper attributes much of the variation in house prices to mortgage interest rates, changes in disposable income, changes in housing supply, rates of household formation, the housing user cost of capital and mortgage availability.

For instance, since 1996 Q3 house prices have increased in real terms by 150% and, even without the estimated effect of buy-to-let, they would still have been expected to increase by more than 130%. It would therefore be incorrect to say that buy-to-let has been responsible for *all* of the growth in house prices over the past decade; however, it has played a part.

Benefits arising from buy-to-let

There is some evidence to suggest that buy-to-let mortgage finance has helped to increase the size of the private rented sector, particularly in recent years. For example, buy-to-let mortgaged properties were estimated to make up more than a quarter (28%) of the whole private rented stock in 2006, rising from less than 1% in 1996 (see figure 3). However, we cannot necessarily conclude from this data that the private rented sector would have declined from its pre-buy-to-let level had buy-to-let *not* existed. This is because the statistics mask the fact that some investors will have taken out buy-to-let mortgages on rental stock that they already owned once the buy-to-let product became available.

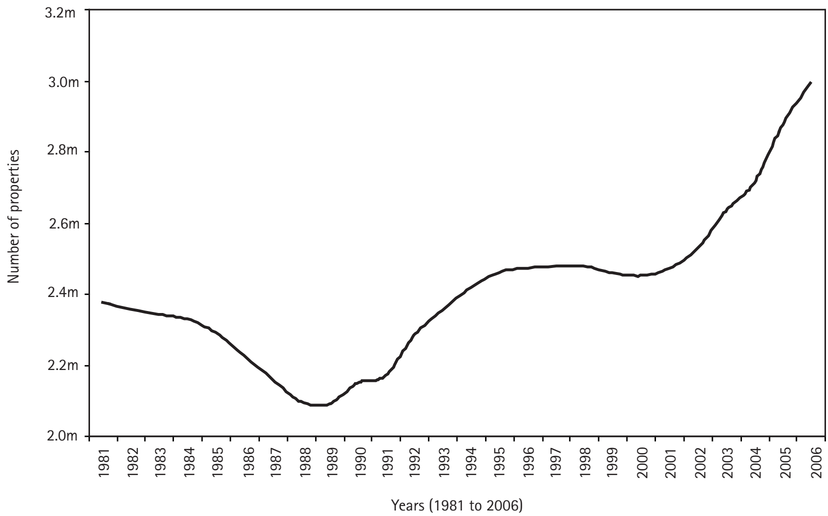
Figure 3: Private-sector rental properties with and without a buy-to-let mortgage



Source: Based on analysis by the Council of Mortgage Lenders (2007)

The size of the private rented sector as a whole was in steady decline throughout most of the 20th century. Its lowest point in England was in the late 1980s, when the sector dropped to just over 2 million properties, representing just 9% of all stock.[5] Following the 1988 Housing Act, which introduced the assured shorthold tenancy, it became easier for landlords to evict tenants where they had a clear right to possession. This played a significant role in helping to expand the sector. The sector was further boosted by the introduction of the buy-to-let mortgage product in 1996, although this did not have an impact until 2000/01, when new lending started to increase rapidly. As a result of these changes the sector now represents 11% of all stock,[6] housing nearly 3 million households (see figure 4).

Figure 4: Number of dwellings in the private rented sector



The private rented sector provides flexible accommodation. This plays a key role in promoting labour mobility and supports national economic growth. The sector also provides housing to those who cannot afford to buy, but are not eligible for social housing. Although tenants do not share in capital gains directly, they do so through lower rents as a result of competition between the increased numbers of landlords.[7]

5 Thomas, R "The Growth of Buy-to-let" in *Housing Finance* no 9 (September 2006)
6 Department for Communities & Local Government figures from 2007
7 Further research is required to estimate the number of tenants that could have afforded to buy a home of their own had there been no buy-to-let lending.

There is also evidence to suggest that buy-to-let has promoted increased housing supply by, in effect, forward-funding housing development. High-density development often requires significant amounts of advance funding to pay for the necessary infrastructure involved. The viability of these cash-intensive developments has been improved through off-plan sales to investors who have provided evidence of take-up to banks and other lenders (owner-occupiers generally purchase much later). The confidence that is brought to a scheme by investor sales has led to a higher number of housing starts in less established residential areas, particularly in town centres that are undergoing large-scale urban regeneration, which generally costs more and is viewed as higher-risk.[8] It should be recognised, however, that mortgage data suggests that approximately only 10% of buy-to-let mortgages between 2004 and 2006 went to new-build properties.

Buy-to-let and future house price inflation

The relationship between house prices and the buy-to-let sector has received much attention. Some leading commentators have suggested that a downturn in the sector could precipitate a slowdown in house price inflation. This could be facilitated in two ways.

First, buy-to-let borrowing could fall as housing user costs rise as a result of higher interest rates or, perhaps more significantly, from the reduced expectation of capital gains. These factors will deter *new* investors from entering the market. Second, if *existing* buy-to-let investors do not anticipate high future capital gains or rental yields, they may decide to sell their properties. This would be more likely if other forms of investment, such as equities, started to outperform the property market.

It appears, however, to be the prospect of capital gains that has motivated buy-to-let investors, rather than rental yields. Rental yields have been falling since 2004. Despite this, lending has continued to rise. A fall in expectations regarding housing price inflation could therefore be more significant than falling rental yields.

The results of the modelling in this study suggest that house price inflation may decrease if the amount of buy-to-let lending declines. This *could* bring a glut of buy-to-let properties on to the market *if* existing investors attempted to sell properties due to lower capital growth expectations. Recent survey research, nevertheless, indicates that nine out of 10 investors wish to either maintain their current property portfolio or to expand it in 2008. Furthermore, fundamental factors, such as increases in real disposable income and

8 Savills Research *The Buy-to-let Market in the South East* (2007)

growth in the number of households in relation to the housing stock, will continue to support price rises.

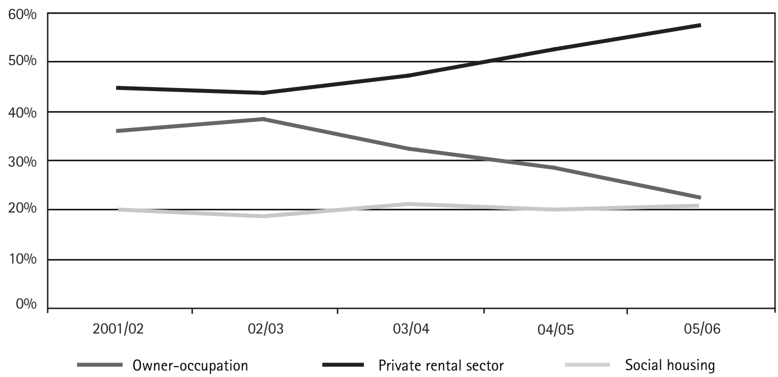
Worsening affordability and the future demand for buy-to-let properties

On the basis of current economic and demographic trends, the demand for rented properties is expected to remain strong. For example, research by Hometrack, based on demographic projections, suggests that there is potential demand for an additional 600,000 private rented homes by 2021. This would increase the sector to around 3.6 million properties. Furthermore, they believe these figures underestimate potential demand due to worsening affordability, along with other factors such as increased migration rates, which will further raise demand.

One of the key factors driving demand for private rented properties is the cost of home ownership. Over the last decade, it has become increasingly difficult for young people to gain a foothold on the housing ladder because house prices have increased at a much faster rate than earnings. This situation is termed "the affordability problem" and is projected to worsen over the coming decade, unless there is a significant increase in supply.[9]

The worsening affordability of market housing has decreased the proportion of new households moving into owner-occupation, and conversely increased the proportion in the private rented sector from 2002/03 onwards. This is shown in figure 5.

Figure 5: Percentage of new households forming aged under 35, by tenure



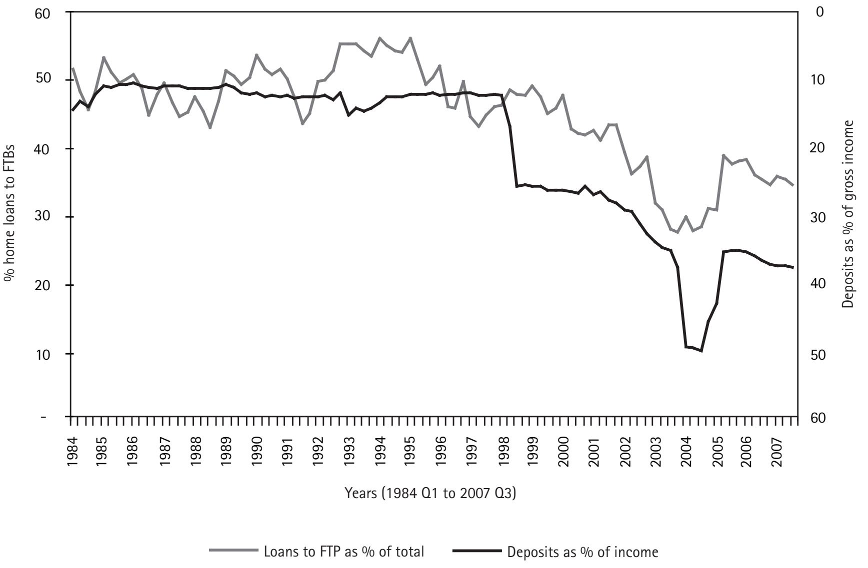
Source: NHPAU analysis of the Survey of English Housing

9 NHPAU figures from 2007

The substitution effect shown in figure 5 can be attributed to affordability constraints on potential first-time buyers, who are typically new households aged under 35.

The proportion of home loans to first-time buyers fell sharply from 2002/03, when affordability constraints particularly began to bite. This is evident by analysing mortgage deposits as a proportion of gross income.[10] Figure 6 shows that deposits as a proportion of annual gross income are able to explain movements in the proportion of home loans going to first-time buyers. For example, when deposits reached a high of almost 50% of income in 2004 Q3, the proportion of loans to first-time buyers dropped to 28% – the lowest rate recorded in the time series.

Figure 6: Deposits as a proportion of annual gross income and the proportion of home loans going to first-time buyers



The deposit constraint on first-time buyers also captures other affordability constraints because it is a function of both lending practices (such as the loan-to-value ratio) and house prices. The so-called credit crunch is likely to further raise loan-to-value ratios. This means that even if house price inflation does decline, or house prices fall, the situation is

10 As declared on mortgage applications

unlikely to improve for first-time buyers. The deposit constraints will continue to bite and a higher number of households are likely to demand private rented accommodation, rather than owner-occupation.

In order for the private rented sector to grow, however, the supply of new homes will need to increase. Previous research by the NHPAU suggests that housing supply will need to rise above household projections if housing market affordability is to improve.[11] An increase in supply would provide more properties for rent, which would help to accommodate those who cannot afford to buy, and increase overall housing affordability.

Conclusions

Buy-to-let mortgage lending appears to have increased house prices since its introduction in 1996 Q3. It is important to note, however, that the impact has been small in relation to the impact from household growth, the size of the housing stock, mortgage interest rates, and changes in disposable income. The growth in buy-to-let has nevertheless had some impact on prices, particularly in recent years. This is not surprising in a market with constrained supply.

One of the key drivers of demand for private rented properties is the cost of home ownership. Over the last decade, it has become increasingly difficult for young people to gain a foothold on the housing ladder, because house prices have increased at a much faster rate than earnings. The private rented sector has therefore become an alternative to owner-occupation, but the sector will only grow further if there is an overall increase in housing supply. An increase in supply would also make housing more affordable overall and take the pressure off all forms of tenure.

11 NHPAU figures from 2007

This chapter is a summary of two reports commissioned by the NHPAU board. It draws on a report by Ricky Taylor titled "Buy-to-let Mortgage Lending and the Impact on UK House Prices: A Technical Report" and the findings from a "Rapid Evidence Assessment of the Research Literature on the Buy-to-let Housing Market Sector" conducted by ECOTEC. Both reports are available in full from the NHPAU website (www.communities.gov.uk/ housing/nhpau).

House price data for this chapter was provided by the Nationwide Building Society; data on economic, demographic and housing variables was obtained from the Office for National Statistics and the Department for Communities & Local Government; and mortgage data was provided by the Council of Mortgage Lenders.

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Chapter 3

Private renting for public good

Adam Sampson, Chief Executive, and Caroline Davey, Deputy Director of Policy and Campaigns, at Shelter

Private renting for public good

What is the private rented sector for? Or – more pertinently – *who* is it for? The private rented sector plays an important role in plugging the gap between social rented housing and home ownership, for people across the income spectrum. Within this spectrum, without doubt, the sector offers high-quality, suitable accommodation for some people. At the same time, however, it provides poor-quality and inappropriate accommodation for others – particularly those at the lower end of the market.

For a long time the private rented sector has been left almost entirely to the market; both in terms of regulation, which remains largely light-touch, and in terms of provision, where there has been no deliberate expansion strategy.

Given the extreme pressure now facing the whole housing market, and the increasing focus on the *private* rented sector to meet *public* housing needs, it is important to consider how best we ensure that the private rented sector is able and equipped to fulfil the roles that are being asked of it.

The role of the private rented sector in "public" housing

It has always been the case that, in addition to providing homes for those who are highly mobile or at a transitional stage in their lives, the private rented sector has served as a valuable intermediate tenure for those on lower incomes who do not qualify for social rented housing, but who are also unable to afford home ownership. In recent years, however, there has also been growing pressure on the private rented sector to meet a series of more explicitly "public" housing needs, and at the lower end it now faces competing claims from across the public sector. These include:

- properties leased by local authorities to provide temporary accommodation for homeless households – over half of temporary accommodation, housing nearly 42,000 households, are leased through such private-sector leasing schemes, and an additional 4,000 households are placed directly with private landlords;[1]
- properties leased to provide accommodation for asylum seekers, again through private sector leasing arrangements;[2] and

1 *Statistical Release*, *Statutory Homelessness: Fourth Quarter 2007, England* (Department for Communities & Local Government, 2008)
2 This forms part of the asylum support function within the casework system operating under the new asylum model. Accurate statistics are not currently available about the number of asylum seekers housed through this system.

- local authorities increasingly encouraging and assisting households into the private rented sector, through tools such as rent deposit schemes, as part of their wider homelessness prevention agenda. Local authorities also frequently work directly with landlords, and in some cases provide landlord incentives to facilitate this.

At the same time, the combination of a lack of social rented housing with soaring house prices has swelled the numbers of the existing constituency of low-income households seeking to rent in the private sector. There has also been increasing competition from newly arrived migrant workers, particularly following the expansion of the EU since 2004. In this context, it is perhaps unsurprising that the private rented sector is straining at the seams.

As demand grows there is a race to the bottom, and those who suffer most are tenants and potential tenants who are least able to compete in the market. Evidence shows that those on the lowest incomes, as well as those who are vulnerable or with unmet support needs, are in no position to exercise choice in the market, which leaves them open to exploitation and to living in the worst conditions.[3]

This situation is unsustainable, particularly as it is so closely linked not only to perpetuating poverty and deprivation, but also to cycles of homelessness. There are two possible options for tackling this: abandon the use of the private rented sector for these kinds of "public" housing purposes; or proactively ensure its expansion to effectively meet demand. The former requires a substantial increase in the social housing sector to take up the slack – and while this is, quite rightly, the ambition of current government house-building plans,[4] it is by definition a long-term approach rather than an overnight solution.

It is therefore necessary to explore measures over the short to medium term that will meet immediate housing need, one of which could be to expand the private rented sector in a more systematic way. Other contributors to this book explore in more detail the possible mechanics of financing and delivering such growth; suffice to say here that there must be a more creative approach to investment and expansion to deliver the scale of growth required.

But what *more* do we need to take into account to ensure that, if there is to be growth in

3 Rugg, J A *Route to Homelessness: A Study of Why Private-sector Tenants Become Homeless* (Shelter, 2008)
4 *Homes for the Future – More Affordable, More Sustainable*, green paper (Department for Communities & Local Government, 2007)

the sector, we provide the right kind of housing to meet the needs of everyone who lives in the private rented sector?

The private rented sector in context

At the broadest level, it is vital that we consider the private rented sector within the overall housing market, and ensure that we have an appropriate balance of tenures at the national, regional and local levels. Any strategic approach to the private rented sector must be seen alongside the government's house-building plans, and in particular the commitment to increase the delivery of social rented housing.

More specifically, however, we need to think about the role of the private rented sector at the neighbourhood and community level. We know that in many areas the sector has had an adverse affect on local communities – particularly in areas with a high proportion of private rented stock and a number of different landlords. In such areas, the lack of an active or co-ordinated approach to housing management has often led to wider negative impacts for the local community as a whole.

For example, the high levels of mobility – in many cases triggered by short-term tenancies – common to the sector mean that tenants are much less likely to settle for long periods and contribute to their local community. High levels of mobility can also lead to void periods between lettings, which can disrupt neighbourhoods, particularly when these last for significant periods. More worryingly for both tenants and their neighbours, absent or unresponsive landlords who do not actively manage their stock can lead to continuing disrepair issues – both internally and externally. This has an impact not only on housing conditions for tenants but also on the quality of the external environment within the local neighbourhood.

It is therefore essential that any strategy to expand the private rented sector takes into account its impact on local communities, and addresses the management issues necessary to ensure that private rented stock works within and as part of the wider housing market.

The private rented sector in detail

As well as making sure that the private rented sector works for neighbourhoods and communities as a whole, it is vital that we make it work for its most important stakeholders – its residents. Many tenants in the sector operate effectively in the market; those at the top end who can easily afford market rents can, and do, exercise genuine choice about where they live. If a property ceases to meet their needs, or the landlord fails to maintain their property, they return to the market to find other, more suitable premises.

We must, however, pay closer attention to the situation of those tenants at the bottom end of the market. Recent research has categorised this bottom end into three parts: the cheapest end of the rental market, the housing benefit market and "slum" renting.[5] Here, choice for tenants is extremely limited, and landlords know it. When the balance of power between tenant and landlord is so heavily weighted in favour of the landlord, many tenants end up suffering in extremely poor housing conditions and on short-term tenancies, with no security about how long they will be able to stay.

Under these circumstances, it cannot be said that the private rented sector serves the needs of its residents. On the contrary, at this end of the market the sector only serves the needs of its landlords and owners. It is clear that further expansion of the private rented sector along these lines would not be in the interest of the "public good". Rather, we must explore how best to expand the sector, while at the same time ensuring that it provides decent, sustainable accommodation for *all* its residents.

The role of buy-to-let

At this point it would be salutary to examine the role of the buy-to-let market in the private rented sector. Since buy-to-let mortgage products were introduced in 1996, the sector has mushroomed in size. There is some evidence to suggest that this growth has helped to increase housing supply through providing advance funding to developers – for example, in off-plan sales on new-build developments – and that buy-to-let mortgage finance has helped to increase the size of the sector overall.[6]

Much of this growth, however, has been among small-scale, amateur landlords. Recent evidence shows that approximately 55% of private rented stock is owned by landlords who own fewer than five properties,[7] 67% of landlords are private individuals or couples,[8] and 68% have another full-time job, and manage their property in their spare time.[9]

The growth in amateur landlords, coupled with a lack of robust regulation in the sector,

5 Rugg, op cit
6 Taylor, R *Buy-to-let Mortgage Lending & the Impact on UK House Prices*, NHPAU research findings no 1 (National Housing & Planning Advice Unit, 2008)
7 ECOTEC *Rapid Evidence Assessment of the Research Literature on the Buy-to-let Housing Market Sector* (National Housing & Planning Advice Unit, 2008)
8 ODPM *English House Condition Survey 2003: Private Landlords Survey* (2006)
9 ECOTEC, op cit

means that many tenants – particularly those at the bottom end of the market, who are unable to exercise choice about where they live – are at risk of unprofessional, sub-standard and in some cases illegal treatment by their landlords. Whether this is through deliberate exploitation, wilful neglect, or sheer ignorance – or a combination of all three – tenants get a raw deal as a result of a system offering insufficient protection. Indeed, this picture goes beyond the buy-to-let market and reflects the problems evident in the private rented sector more widely.

The buy-to-let phenomenon therefore presents a mixed picture. While there are indications that it has had positive effects in terms of growth in the sector, outcomes have not necessarily been favourable in terms of the quality of management, in particular, for tenants. At its heart this reflects the wider challenge across the private rented sector as a whole – how do we put in place the right conditions for investment and growth, while at the same time protecting the interests of tenants and communities, in particular those at the lower end of the market? This is the dichotomy we need to address in any future expansion of the sector.

Where do we go from here?

We now have a very real opportunity to reshape the private rented sector, both in its own right and for the public good. Experience of the sector's expansion over the past decade teaches us lessons that we can – and must – learn about how to improve it. Equally, the government's commitment to long-term growth in house building overall, as well as to tackling poor housing conditions, sets the framework for positive and proactive forward planning.

The first place to start must be with a vision of what we want the private rented sector to look like – and whom we want it to serve – over the long term. As outlined at the beginning of this chapter, the sector is currently being used to provide "public" housing for a range of different groups, largely because of the lack of ready alternatives. Which of these groups are expected to shift into the social rented housing sector as this expands over time – or indeed into the home ownership sector – and which, such as migrant workers, are expected to stay? Following on from this vision, we can begin to make a more realistic assessment of the capacity of the private rented sector, and take a more proactive approach to ensuring it provides high-quality accommodation, both now and in the future.

Approaches to drive up growth in the private rented sector – in terms of absolute numbers as part of overall house-building plans, as well as potentially in terms of growth as a proportion of housing overall – will then need to address two areas in particular.

First, investment: over the past decade finance in the sector has been largely driven by individual buy-to-let landlords, but there are opportunities to attract larger-scale, institutional investors who will provide a more stable basis for growth in the long term. Could this, for example, include a greater role for housing associations in offering property to rent at market rates, in addition to more traditional institutional investors?

Second, proactive growth in new developments: we know that there is going to be significant housing growth over the next decade, much of which will be concentrated in new developments such as growth areas, growth points and eco-towns. If we accept – as we must – that a certain proportion of new stock in these developments will be privately rented, we need to engage actively at the planning stage with the best existing and potential landlords to ensure that provision is well managed and of a high quality, rather than leaving it to chance.

At the same time as assuring an appropriate growth strategy for the private rented sector, we need to pay close attention to standards and practice across the sector. It is vital that we drive up standards so that *all* tenants in the private rented sector can be assured of minimum rights and conditions from their landlord. To date, evidence suggests that the current light-touch, market-based approach has not succeeded in ensuring the quality that we need. In this context, we must explore a combination of incentives, good practice and tighter regulation where necessary. We must also acknowledge that this approach will mean that some landlords will leave the market – but that this must be the right decision if these landlords are unwilling or unable to comply with the standards expected of them.

We have a good base to start from, both from the Housing Act 2004 and from continuing good practice work that Shelter and others have been developing over recent years. It is now time to mainstream this work, balancing incentives with enforcement to create the right climate for change.

Conclusion

The private rented sector provides a vital intermediate tenure between social housing and owner-occupation, and undoubtedly has a significant role to play both now and in the future. In every discussion around finance, investment and growth, however, we must remember what the sector is really there for: to provide homes for its residents. We must also remember that the private rented sector may be part of the solution to housing problems, but it is not the whole solution. The sector must be seen in the context of its place within the housing market as a whole, and with this must go the recognition that the sector will be appropriate for some people, but that others will be better served by other tenures.

At the heart of ensuring that the private rented sector fulfils the roles being asked of it is the need to professionalise the sector. For far too long it has been left to individuals to choose whether or not to invest and become landlords, and then to the discretion of those individuals how seriously they take their role as housing managers. It is in recognition of the *importance* of the private rented sector that we must remedy this situation, and adopt a far more proactive and strategic approach to its management, development and growth. Only when we do this, and consequently drive up standards of *all* accommodation across the private rented sector, will we be able to say that private renting genuinely makes a contribution to the public good.

Chapter 4

A future for the small landlord

Ian Potter, Operations Manager at the Association of
Residential Letting Agents

A future for the small landlord

As the credit crunch continues and house prices come under threat, the prospects for the private landlord are thought by many to be bleak. This market correction, however, could prove to be just the window of opportunity required to provide a stable and well-managed tenure, and provide real choice in the housing market. This chapter will show how the future for the small landlord can be bright, but to ensure that this is so, a series of progressive reforms may be required. It makes the case for essential changes to the regulatory and fiscal regime that will help to both increase supply and raise quality standards across the private rented sector.

The case for a "light-touch" approach

The Association of Residential Letting Agents (ARLA) has long campaigned for light regulation of the private rented sector and the creation of a more level playing field for all concerned – landlords, tenants and agents. We would welcome encouragement from government to extend the scope of licensing, and to have redress available to landlords and tenants should agents and managers fail to provide a satisfactory level of service.

It was hoped that government would take the opportunity to include letting agents when it was introducing a mandatory redress scheme for estate agents. This opportunity was missed, however, and the definition included in the Estate Agency Act 1979 was used instead. At the time of writing, even this element of consumer protection has been delayed.

The framework for the structure ARLA has proposed would see *all* agents licensed. This would help ensure that rented properties comply with a minimum standard based on the Housing Health & Safety Rating System legislation, contained within the Housing Act 2004. Licensing would require all agents to be members of a redress scheme, such as that operated by the Ombudsman for Estate Agents, and to have professional indemnity insurance and client money protection to cover those funds not protected under tenancy deposit schemes.

Landlords involved in property management would be required to subscribe to an actively managed accreditation scheme operated by the local authority. Many local authorities are establishing such schemes, but these are being operated by default, given that landlords can self-certify. Self-certification can work only within a framework that allows enforcement by the authority.

Local authorities must adopt a more proactive approach. Where the local authority is operating a scheme, it should not be for the tenant to instigate complaints. To do so can place tenants in a vulnerable position, where less than reputable landlords often carry out "retaliatory eviction". In most cases this is legal, but serves only to move the problem on from one tenant to the next. Consideration needs to be given to making action to comply with the Housing Health & Safety Rating System mandatory before re-letting is allowed to take place.

A landlord registration scheme has been introduced in Scotland, whereby all landlords are required to register with the local authority – landlords must meet standards or face ensuing penalties. This was recently supplemented by the requirement to have a chapter 4 notice under the Housing (Scotland) Act 2006, which requires landlords to maintain property standards and meet repair obligations, while advising tenants of their right to go to the Private Rented Housing Panel should repairs not be carried out. It is unfortunate, however, that both government and local authorities have collectively failed to ensure that all landlords are registered.

Fiscal opportunity

A key challenge for the sector is how to improve and maintain the quality of the fabric of older properties, in particular in inner-city areas. Much of this stock is being allowed to fall into disrepair and is left below tolerable standards. Grants are not always available, and can be a slow and cumbersome method of achieving satisfactory results. This section argues that fiscal incentives could prove a more effective alternative. Generally speaking, landlords are not treated as businesses within the fiscal regime. This can act as a disincentive to producing well-managed and well-maintained properties in certain parts of the market.

If capital allowances were made available to landlords upgrading older property – for example, property over 70 years old – this could go a long way towards improving the quality of private rented stock. These capital works – replacing kitchens, bathrooms and windows or installing central heating (which would improve energy efficiency) – could be set against income tax *at the time of completion*, as opposed to requiring them to be set against capital gains tax at the point of sale or transfer. Over time this could become tax-neutral, as it would have the effect of raising the value of the property under the capital gains tax computation. Claw-back mechanisms could be put in place if the property were taken out of the rental market during an allocated period of time. This would help encourage the long-term provision of housing within the private rented sector.

Another option would be to increase the landlords' energy saving allowance (LESA) to include the installation of central heating systems. As the allowance stands, uptake is low, and there is a greater role here for both HM Revenue & Customs and local authorities to raise awareness of such fiscal allowances. To be effective, however, these allowances must be made meaningful, and broadening the criteria to include central heating would be one way of achieving this.

If the government wants small landlords to be "green" and meet energy-efficiency targets, greater consideration will need to be given to how fiscal incentives can help achieve this. In particular, these will need to be aimed at older properties, where survey reports and energy performance certificates can help point to those most likely to benefit from this investment. Consideration will also need to be given to how incentives can be provided to cover blocks of flats, where it is difficult for landlords to individually install cavity wall insulation. If incentives were provided to encourage landlords to collectively insulate blocks, this would both have a beneficial environmental impact and benefit owner-occupiers.

Changes to stamp duty could also provide a financial incentive for the purchase of property for letting. Large investor landlords are commonly deterred from buying blocks of property, as stamp duty is based on the total value of the transaction, rather than the value of individual properties within the block. This has the effect of placing the duty at the highest rate. Where this is the case, and the landlord upgrades the property within a given timeframe, the stamp duty could be made refundable – again, with claw-backs in place when the property is taken out of the rental market.

A further fiscal option is to allow VAT to be reclaimed for certain types of transaction. Most landlords pay fees to a letting agent, which are subject to VAT. Part of this transaction is for the collection and transfer of monies which, under European guidelines, it could be argued are not designated VAT-able services.

The removal of VAT on the purchase of materials and labour for capital expenditure to improve older property brought into the rental market would be an incentive to the landlord and could eventually be tax-neutral. A VAT receipt would be required as evidence of the works carried out, which would also deter "black economy" transactions from taking place, where contractors are paid cash in hand.

Availability of finance

The financial markets are going through a significant amount of turmoil. Lending institutions are withdrawing mortgage products on a daily basis, while other lenders have closed their books to new business. This is going to have an adverse impact on the supply of buy-to-let and could put at risk the recovery of the private rented sector, leaving people unable to secure property under any form of tenure.

There is a role for government to step into the mortgage market, to encourage landlords to support the private rented sector by expanding their portfolios and to discourage investors from quitting the sector all together. This is, however, a difficult area for government intervention, as most lenders will need time to recover from sub-prime debt problems and to build the resources and confidence to once again lend to each other. Lenders will be restricted to the margin between the interest income and the loan interest paid on their books. One option may be a requirement for an agreed percentage of their mortgage lending portfolio to be made to investor landlords. This would be a light touch of regulation, which could assist in ensuring a more steady flow of rented property to the market. It would also help to ensure that the lender was looking for the quality deal, where the market research had been properly carried out and the landlord or borrower was adhering to reasonable and sensible predictions on rental demand and level from experts in the area, rather than on over-hyped assertions from developers.

Mortgage lending by government is not a radical proposal. This would assist investors in the private rented sector and help prevent high borrowing rates from raising inflation. The mortgage famine has unfortunately come at a time when government has chosen to amend capital gains tax rules, which many commentators believe could lead to landlords selling their property before prices fall further.

Without necessarily subscribing to this theory, it does have to be pointed out that rental income struggles to cover mortgage payments in many areas. With rental yields varying at about 4-5% on cash purchases, and negative to very low return applying in some areas given average gearing,[1] landlords are often dependent upon the prospect of capital growth. A stimulus is needed, even if short-term, to protect the contribution from buy-to-let landlords to the whole UK economy, which has been estimated at around £30 billion.[2]

1 ARLA Quarterly Index, fourth quarter 2007
2 ARLA *Buy to Let: The Revolution 10 Years On* (2006)

The future

The future, despite all the doom and gloom, is actually very bright for the small landlord. We have a growing population, particularly among the key groups that make up the tenant market – including the immigrant population, students, the elderly – and a mobile population that changes jobs and moves residence at a rate thought impossible a generation ago.

Investor landlords must do their market research, and with more than one expert in each local market (as supposed to relying on internet research, which provides a superficial picture of what is available and at what rent). Landlords must ask the relevant questions, including the level of tenant demand, the likely void period, expected running costs, and projected rental yields.

Even with new incentives for buy-to-let landlords, the rental yield is unlikely to significantly outstrip borrowing costs. It is well known that the higher the rate of return, the greater the risk. Equally, however, it has been well proven that property values increase over the long term. Investors must be prepared to make a longer-term commitment.

Landlords will face a changing market, including growing legislation and regulatory pressure. This will require landlords to be more professional and will do no harm to the industry. Over time, this will improve the image of the landlord and give the consumer greater confidence, removing the slowly decreasing stigma of the private rented sector, and providing for the long-term financial welfare of the investor.

Chapter 5

A home for institutional capital?

Mark Long, Head of Research and Strategy at Invista

A home for institutional capital?

The government has placed the provision of new housing firmly at the centre of its policy objectives, but without significant institutional investment this goal may be unattainable. Looking at the historical performance of the residential sector produces two clear-cut arguments for institutions to hold a significant proportion of their assets in housing. Firstly, UK residential investments have yielded a stronger and more stable performance than both equities and gilts; and secondly, within a multi-asset portfolio residential investments have provided significant diversification benefits, because of their low correlation with UK equities and gilts.

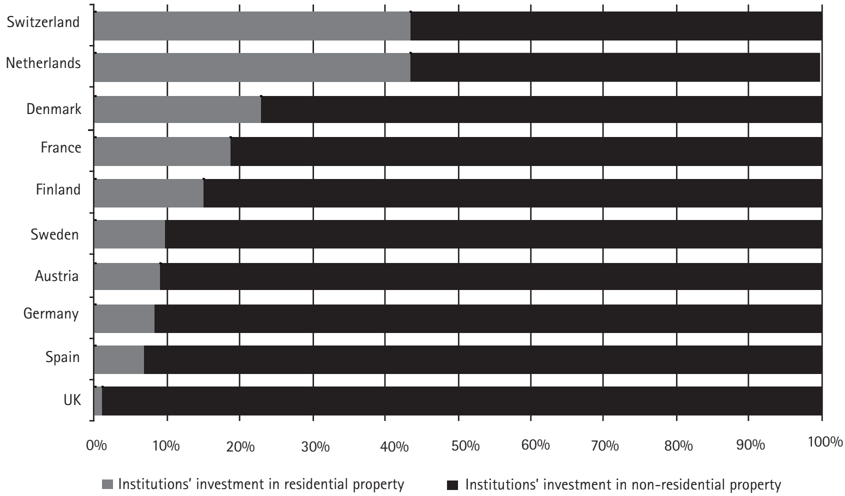
This chapter takes a closer look at the reasons behind low levels of institutional investment in the UK and suggests some practical ways forward for government, including changes to planning, taxation and lease structures. The sector itself, however, also has a role to play in encouraging investors and must deliver a more sensible mix of housing types for rent and encourage more professional management operations.

Barriers to investment
British institutions invest a significantly smaller proportion of their property portfolios in housing than their European counterparts. There are a number of reasons for the apparent ambivalence of UK institutions towards residential investment. Historical experience of over-regulation, reputational risk and, until fairly recently, a general trend in asset allocation away from property are all key factors in determining where institutional portfolios are today.

This trend is now beginning to change, with institutional investment in residential property having gradually risen over the last decade. Institutions, however, appear to have focused the majority of their attention on those residential investments with many of the characteristics of commercial property investments – those with long leases, strong covenants and fixed uplifts, such as student accommodation and retirement homes.

Conversely, private investors have embraced residential investment like never before, through the buy-to-let market. Rather than investing through an independent financial adviser in managed funds, which are often heavily weighted to equities, a large number of private investors have opted to put their money directly into the residential sector. This growth of the buy-to-let market has been matched by the subsequent returns that private investors have received on these highly geared investments, with prices having doubled on average over the last seven years. The average buy-to-let investor will have seen their equity more than quadruple. While this has been a strong growth area for private investors, institutions have not followed suit, owing to a number of barriers to large-scale investment – some of which are real and some of which are perceived.

Figure 1: European property holdings by institutions, 2006



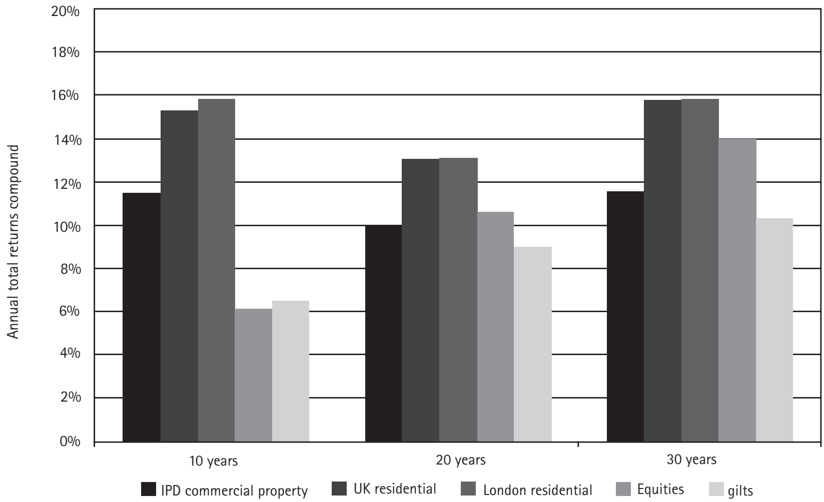
Source: Savills, IPD

One very real deterrent to greater levels of institutional investment in the residential sector has been the sharp increase in the taxation burden that the property industry has borne over the past decade. In this respect, institutional investors are penalised in terms of both higher levels of stamp duty than individuals (due to the larger lot sizes) and their inability to reclaim VAT on repairs. One method of encouraging institutions to invest in the residential sector is to grant exemption or reduce the rate of stamp duty paid on privately rented properties, and enable investors to reclaim any VAT incurred on the management of their rented properties. A potential solution is to charge stamp duty at an individual property level, rather than a portfolio level. This would level the playing field between private buy-to-let purchasers, who typically acquire one property.

Another important barrier to residential investment often cited by institutions is the fragmented nature of the market and the relatively small lot size of individual investments.

For larger institutional investors, the average lot size of their property acquisitions has increased steadily over the last two decades to more than £10 million. With the vast majority of developments built for owner-occupation, there are relatively few potential investment opportunities that meet these lot size criteria.

Figure 2: Investment performance by different asset class to end-2007



Source: Savills, IPD, Thomson Datastream

While this may seem a relatively banal reason for not investing, the rationale of gaining economies of scale is a strong one. The amount of management time expended on a single, £10 million office block, let on a long, full repairing and insuring lease to a substantial corporation, is far lower than the management costs incurred from running 50 flats let to individuals on short leases where the landlord is responsible for repairs and insurance. Any solution to encourage institutional investment in the private rented sector must address the problem of the lack of investable stock through changes in the planning system or economics of development.

Barriers to building

The planning system in the UK is a significant drawback to the provision of a sufficient number of new dwellings to meet demand. It is encouraging to see that the government is trying to address a number of deficiencies in the planning process by seeking to speed up approvals and loosen supply. To date, however, this has largely been focused on the social and owner-occupation markets, with little or no thought given to the role that the private rented sector can play.

This may change over the next few years, as the government finally recognises that the private rented sector – and especially the buy-to-let market – has a positive role to play in increasing the provision of housing, rather than crowding out owner-occupiers. Recent reports by London Residential Research and the South East England Regional Assembly have concluded that the number of new homes developed has increased as a result of buy-to-let investors underpinning the economic viability of development projects.

Over the next few years, higher interest rates and weaker house price growth are likely to reduce the supply of new homes through lower buy-to-let and owner-occupier demand. This may provide the ideal opportunity for institutions to enter the investment market, should the apparent barriers to investment be overcome.

In investment terms, the residential property market is very different from the commercial. In the residential market, values are determined separately from current and future cash flows, whereas in the commercial market the cash flow determines the value of the investment. This is the result of the dominance of owner-occupiers, rather than investors, determining the value of homes. Many institutional investors regard this as an additional risk to residential investment.

Probably the biggest barrier to increasing the supply of new homes, however, is the onerous burden of social housing and section 106 costs. With developers in London forced to provide up to 50% of new homes at low- or zero-profit social housing, the risk premium or profitability on the private housing must commensurately increase. A key issue here is that the private rented sector is not differentiated from the owner-occupied sector when considering planning gain or the provision of social housing.

Practical ways forward

There are two possible routes to increasing the provision of privately rented accommodation: either a planning use class for privately rented accommodation (with a greatly reduced social housing component, or none at all) or a licensing scheme whereby a development would be licensed to be privately rented for a number of years, after which time the developer or owner could realise a significant reversion to full open market value.

The latter was a key recommendation of a recent study undertaken by Savills for the British Property Federation and the Greater London Authority. The report identified that a designated planning use class would have negative long-term effects on the housing market and would in effect create another tenure with similar characteristics to social housing, in that the reversionary value of the investment would be removed. Therefore a licensing system, negotiated through the section 106 regime, was the recommended way forward. This approach would meet both the government's objectives of increasing supply and institutional investors' objectives of providing an asset class that is priced more closely to the cash flow derived from the investment with a reversion to full market value.

In addition to potential changes to the planning system, more thought should be given to the type of property being built. UK house builders currently have a less than enviable reputation for the quality of their buildings. That said, they are acting entirely rationally, building a product for very short-term gain – sale to owner-occupiers. The product delivery is entirely focused on the desirability of individual units to individual owner-occupiers, rather than the efficient functionality of the entire development – something which an investor may favour.

There are a number of possible solutions to this: increase the National House-Building Council guarantee period to 25 years rather than the present 10 years; tighten building regulations; and raise enforcement levels closer to those in Continental Europe. This may encourage the development of more robust and efficient developments, designed and built to be run as a single entity. Before any significant change in the functional design can occur, however, demand must exist from large-scale investors for the product, which again raises the concept of licensing or a planning use class.

On its own, a new use class or licensing system is unlikely to kick-start the market, as institutions are unlikely to direct a significant proportion of their investments towards a new and untried asset class. What will be needed is an injection of significant capital. Outside of public subsidy, the only place that this can come from is existing investors in the buy-to-let market. In order to tempt these investors away from direct ownership, some form of tax-efficient transfer of their existing assets into a pooled institutional investment structure is likely to be necessary.

The government may indirectly be encouraging private investors into pooled professional investment structures through increased regulation, such as licensing for houses in multiple occupation, the tenancy deposit scheme and requirements for annual gas safety certificates (the absence of which is a criminal, not civil, offence). Many private investors, however, are oblivious or unaware of both the regulatory and financial risks they are running within their often highly geared portfolios. In practice, these burdens fall on large professional residential landlords, who fail to avoid the onerous legislation aimed at the smaller landlord.

One area in which institutional investment has flourished in the residential sector is where the investment has been transformed into something that looks like a commercial investment. The provision of longer leases to stronger financial covenants has been a key factor underpinning the development of institutional investment in the student accommodation market. This model can easily be transferred to other parts of the residential market through social and intermediate PFI housing, where the rental cash flow is either wholly or partially underwritten by government or quasi-governmental institutions.

Alternatively, the development of a wider range of intermediate landlords, who stand between the property owner and individual occupiers, could be encouraged. These already exist in the serviced apartment sector, so why should there not be similar intermediate landlords specialising in the delivery of mainstream private rented properties, or even providing intermediate or social housing? These types of investment would be immediately attractive to institutional investors and valued on the same basis as the commercial investments with which they are already familiar.

In addition, the separation of ownership and management would overcome a number of the most commonly highlighted issues for institutional investors – the high burden and cost of management, the relatively low level of net income yield, and the lack of specialist professional managers.

That said, there may not be enough profit on the table to make this type of structure attractive outside the serviced apartment and student accommodation market.

This is, nevertheless, unlikely to go the whole way towards encouraging institutional investment in the private rented sector. Institutional investors have become increasingly focused on income-generating assets. On a risk-adjusted basis, an asset class that has weaker tenants and shorter leases than the commercial market might be expected to produce premium levels of income return. The income return, however, is only half of the total return equation, a factor that buy-to-let investors have fully embraced.

Conclusion

The greatest danger to continued institutional investment in the residential sector may be too much change, too rapidly. Too great an increase in the provision of new accommodation could result in oversupply and falls in values and rents, which could set back residential investment another 20 years. The ideal scenario would be one of reasonable growth of the sector on the back of significant improvements in the attraction of the private rented sector to institutions through changes to planning, taxation and lease structures. The sector itself must deliver a sensible mix of housing types for rent and encourage the development of more professional management operations. In addition to this, the broad population will need to be encouraged to adopt a more favourable view of living in flats, closer to that held across most other EU countries.

Chapter 6

Demand-driven innovation

Mark Allan, Chief Executive of the UNITE Group plc

Demand-driven innovation

I am 20 years old and I want a nice, safe place to rent, in a good area.

I have only just started my first job and I'm not ready to settle down yet.

We need to do some serious saving before we can afford to buy our own place.

I need staff who are prepared to move around a lot. If we can help them find somewhere to live quickly, it helps everyone.

My family home is too big for me now. I'd like to find somewhere smaller, that's comfortable and easier to manage.

These are the voices of potential customers who want to rent. By listening to their needs, creating the products and services that they want and managing these to a high standard, we can expand the private rented sector and innovate new markets within it. We know, because we have done it.

I am referring to purpose-built, professionally managed student accommodation. In 10 years the market has grown from zero to a value of £6.5 billion, from a few hundred beds managed by corporate landlords to over 100,000, and from almost no institutional investment to more than £2 billion attracted by the UNITE Group plc (UNITE Group) alone. The purpose of this chapter is to show how demand-driven innovation can improve and expand the private rented sector. We will share the story of the UNITE Group, the UK's largest provider of student accommodation, and consider how the lessons learned can be applied across a much wider challenge: the challenge of repositioning and reigniting England's housing offer.

Repositioning the private rented sector

The private rented sector has long been the poor relation of the housing sector, struck low by high-profile scandals over rogue landlords, difficult tenants on run-down estates and get-rich-quick stories from buy-to-let. As the Law Commission observes:

The private rented sector continues to suffer from a poor reputation, which, arguably, prevents it playing as full a part as it should in both local and national housing markets.

Today, however, the private rented sector is at the forefront of an important debate. This presents a much-needed opportunity to give the sector a new lease of life.

Some important steps are being taken to realise this aspiration. The forthcoming review of the sector marks the beginning of an important debate in policy circles regarding how the sector can better meet national housing demand. The sector is also gaining increasing recognition at a city level reflected in the new Mayor of London's 2008 housing manifesto.

Reinvigorating housing supply

The private rented sector can be split into two distinct areas: existing housing stock and new-build. The tenant base also can be clearly defined as comprising those who rent as a lifestyle choice and those who have no choice but to rent due to financial constraints. The UNITE Group's contribution to this debate is focused on increasing the supply of new purpose-built and serviced stock for people who choose to rent as a lifestyle choice.

Many local authorities, however, do not recognise new purpose-built student housing as contributing to the supply of housing stock. In planning terms, student accommodation is not even classed as residential. On the upside, this has enabled new student housing stock to be created relatively quickly. The downside is that local authorities rarely consider the opportunities the sector can bring.

Wider benefits

The lack of recognition the student accommodation market has received can partly be put down to negative stereotyping. Many of us went to college or university, or know friends or have children who did. The grot and grime, from leaky roofs to explosive wiring, will be familiar stories.

Many of these preconceptions, however, are out of date. Student accommodation has been transformed in the past 10 years. Education has become serious business, and knowing what the customer base wants will be key to future success – both in the student accommodation subsector and in the wider rental market.[1]

Purpose-built student accommodation can bring many benefits, not least taking students out of the traditional private rented sector and freeing up much-needed housing stock.

1 We have learned from the fast-moving consumer goods industry and put customer research at the heart of every decision we make. We talk to around 10% of our customer base every year to find out their level of satisfaction with products and services and how we can make them better for future customers.

For each UNITE Group development of 400 beds, up to 80 family-sized homes can be released back into the housing market.

Delivering new rented stock has also been found to bring wider regeneration benefits. Through building on brownfield sites in urban locations, many student accommodation developments have catalysed further development and breathed new life into city centres.

In Birmingham, for example, UNITE Group worked closely with local stakeholders to help a local manufacturing business to move to better premises, while redeveloping an area close to Aston University for student accommodation.

In London, an award-winning scheme helped a failing primary school to turn around, with the innovative development of a mixed-use facility including a 12,000 sq ft ground-floor primary school with 168 student bedrooms occupying the floors above.

There is also scope for new rental developments to change behavioural patterns. Through building stronger relationships with occupiers, a platform can be created for changing attitudes towards environmental sustainability.

In Sheffield, UNITE Group is piloting several projects with its client base to "reduce, reuse and recycle" resources. Customers are encouraged to change their behaviours through a combination of information and cash incentives, working to reduce electricity and water usage and encourage recycling, using local charities to reuse equipment left by customers at checkout time.

Attracting investment

Negative stereotyping is by no means restricted to the student accommodation market. The poor public image surrounding the private rented sector as a whole has been one of the biggest barriers to its growth and development. As the UNITE Group example shows, one way to improve perception is to seek inspiration.

The private rented sector needs to learn from other consumer-facing businesses by becoming more customer-focused and demand-driven. There came a point in the UNITE Group's history when we stopped being just a developer of student accommodation and started operating as the biggest student "hospitality" group in the UK – providing a package of housekeeping, security, maintenance and reception services. The private rented sector similarly needs to break out of the mould and think about how to differentiate products and services, how to brand them and how to add services to better meet demand. It is about changing the mindset of the developer and investor. Housing is not just about bricks and mortar; it is about creating a lifestyle too.

The private rented sector needs to wake up to the opportunities around it – to service people who are looking for high-quality, flexible places to rent, geared and marketed to their needs, and by a trusted brand. We need to be realistic: this is not going to happen overnight. It has taken just over five years for branded, professionally managed student accommodation to become an institutionally recognised asset class. But with innovation and insight, it can happen.

Becoming more demand-oriented is also a precursor to attracting institutional investment, one of the primary opportunities for future growth. Institutions have not invested heavily in residential property despite the sector outperforming other property investment classes. This has not only been due to the sector's poor image; structural barriers to investment have also played a role, not least a national housing policy favouring owner-occupation.

A closer look at UNITE Group's student accommodation model, however, demonstrates the level of commitment that the private rented sector can secure from major institutions. There is growing recognition that this model can provide a useful example for the future development of the sector as a whole.

In 2006 UNITE Group set up the £1 billion UNITE Group UK Student Accommodation Fund, an open-ended property fund focused on owning and acquiring UK direct-let student accommodation. The fund is Europe's largest unlisted specialist student accommodation investment vehicle, holding £850 million of gross property assets and attracting £370 million of third-party equity.[2] Success has been achieved through communicating to investors market opportunity, using published research and analysis – demonstrating the resilience of the sector, the growth in long-term rental returns and availability of lot sizes. By developing a leading brand and an expert management platform, through strong relations with stakeholders (universities and the wider higher-education market), investors were shown that high-quality management structures can be put in place.

2 In 2005 the UNITE Group formed a joint venture with GIC Real Estate to develop and operate student accommodation. This joint venture is now fully invested and holds some £400 million of gross property assets, GIC having committed £50 million of equity.

A supportive planning and regulatory regime

A key learning point from the UNITE Group model is that institutions need certainty to invest. Developing a trusted brand and a robust management platform, tailored to the specific needs of the user group, can be a major stepping-stone towards achieving this.

If this investment model is to be replicated across the private rented sector, however, it is clear that modifications to both regulatory and planning guidance will be essential. Prevailing conditions in the wider rental market point to the need for a light-touch regulatory system. The importance of ensuring high-quality conditions cannot be underestimated if institutional investment is to be forthcoming. Training and codes of standards (and communicating these to tenants) will have a fundamental role to play if perceptions are to change.

The planning system will also need to be more responsive. There are several options available, including the development of a new planning use class and/or the relaxation of a number of building and planning regulations that constrain the market. Fundamentally, the planning outlook needs to change from thinking primarily in terms of owner-occupation to encompassing other forms of much-needed residential development. This will require a clear statement of intent at all levels of government on the planning mechanisms necessary to promote this change, where the detail of demand is proved through focused housing need surveys and controlled through section 106 agreements.

Conclusion

This chapter has shown how a more innovative and demand-driven approach can enable the private rented sector to make a significant contribution to the UK housing market. The UNITE Group and others have succeeded both because of the housing and planning system and in spite of it, by using demand-driven innovation to inspire confidence in a sector that all too often does not do so.

The key message from this contribution is that the private rented sector needs to be repositioned and rebranded – away from the bricks and mortar of last resort, into a first-class lifestyle choice for the future. To accommodate this, the regulatory and planning system will need to change with the market. Learning from the purpose-built student accommodation model, greater flexibility in planning and tighter regulation in management will be required if we are to attract the level of institutional investment necessary to satisfy demand and raise quality standards. Following the current restricted path of residential development will not yield the product, rental level or speed required.

Appendix: A summary of the student accommodation market demand and supply fundamentals

The government has set out robust targets for increasing participation in higher education. In the decade between 1996 and 2005, total participation at UK higher-education institutions grew by 31%, from 1.75 million to 2.34 million, with 76% of full-time students enrolled in universities outside their home county and 56% of students living in the traditional private rented sector.[3] As student numbers, both from home and overseas, continue to grow, the proportion of students entering the private rental market is expanding and there needs to be a plan for where they will live.

The following information, sourced from research conducted by DTZ in March 2006 and King Sturge in 2008, provides a snapshot of the demand and supply imbalance in the student housing market. While understanding that the review focuses only on England and Wales, the facts set out below provide insight into both how student housing interacts with the wider private rented sector and likely future trends in terms of demand and supply.

Long-term increasing demand for student accommodation

- Student numbers in the UK have increased by 19% in the last five years. Average annual growth between 1999 and 2005 was 3.2%.
- Between 1996 and 2005, full-time student numbers increased by 225,000, equating to an increase of 21%.
- Student numbers in full-time higher education increased in 2007 by 5.8% to 1.4 million.
- Participation in higher education stands at 46% for individuals between 18 and 30. The government is aiming for 50%.
- Our estimates suggest that by 2011, there will be a further 200,000 students in the UK. As such, the total number of students will be approximately 2.5 million.
- Demand for student accommodation is forecast to increase by 3% pa to 1.2 million students in 2010.

A shrinking supply of decent places to live for students

- The majority of students reside in the private rented sector (56%), a further 15% live in university-owned accommodation, 13% live with parents, and between 6% and 8% live in commercial halls of residence.

3 Savills *Student Housing Report* (2007)

- On average, universities in the UK have capacity to provide a bed for only 20% of their students.
- Reliance on the private rented sector varies; for example, only 29% of students at the University of Leeds are living in privately rented properties, while the figure at the University of East Anglia is 87%. Likewise, in terms of measurement by city, there is also a variance – for example, 90% of students in Luton live in private accommodation, while in Stirling this applies to only 17%.
- There has been a strong increase in the number of privately developed, purpose-built beds since 2005 (by 36% to 123,536).
- Significant opportunities still exist in London, with its supply-demand imbalance, although this may be somewhat tempered by an increasingly restrictive planning regime.

Chapter 7

Second-hand, not second-best

Liz Peace, Chief Executive of the British Property Federation

Second-hand, not second-best

Initiatives to meet the crisis of undersupply in the UK's housing market focus primarily on building new homes for purchase. As a result, all the attendant pressure is being piled on issues concerning land supply, planning and the numbers that volume house builders are willing or able to produce. As this monograph shows, there is another way of meeting at least some of the supply deficit: through increasing investment in a professional private rented sector. Even here, however, the tendency is to look at ways in which new construction can be encouraged to provide sufficient properties for private renting.

Substantially increasing the number of new-build properties coming on to the market will be fundamental if we are to increase overall supply and meet rising demand. Indeed, the British Property Federation is vigorously promoting a new policy of "build to let" as an alternative way of meeting affordable housing requirements.[1] There is, however, another way. That is to look at making more efficient use of existing properties that are sitting empty or being used less effectively than they might.

The objective of this chapter is to illustrate the importance of releasing this potentially valuable source of housing and to explore the reasons why these premises are not being used to ameliorate the pressing crisis. Some practical ways forward will then be examined that may bring these properties back into productive use.

A source of supply the government cannot ignore

The Empty Homes Agency estimated that in 2006 there were some 663,000 properties vacant in the UK, of which approximately 288,000 were long-term vacant. These figures, however, ignore the space that is available in commercial properties, usually above shops. This space has the potential to be used for homes, but for a variety of reasons is left empty. Estimates made by the Living Above Shops Taskforce (2003) revealed that there could be over 100,000 empty units.

There are also other properties, which would be suitable for family occupation but are occupied by single, often elderly, people who for many reasons (including the lack of suitable accommodation in their area) choose not to move out. In addition, there are the houses in university towns that are taken over as multiple student lets, mainly because of the absence of a suitable hall of residence.

1 GLA *Overcoming Barriers to Institutional Investment in Residential Housing*, working paper 29 (2008)

It is impossible to put a figure on these latter two categories, although UNITE Group[2] estimates that every 400-bed hall of residence that it provides releases 80 units of family-type housing. A modest building programme of student halls and suitable elderly persons' accommodation might therefore provide a substantial number of additional family homes for rent in the short-term future.

In light of the challenges to meeting the government's stated requirement for 240,000 new homes each year, not least the uncertain macroeconomic backdrop, these numbers represent a source of supply that the government cannot ignore. They also represent a source of potentially desirable "character" accommodation that is likely to appeal to renters who desire something different from the mass-produced apartment block.

Where the problem lies: commercial viability

It would be naive, however, to think that all that is needed is a few pronouncements of policy and this accommodation would suddenly become available. The difficulty with most properties that have been empty is that they require a substantial amount of work to bring them to a habitable standard. The same would apply to houses vacated by students, many of which may have been converted into individual bedsits.

Vacant premises above shops have their own additional set of problems, arising from the mixed use of the same building and the different approaches to commercial and residential tenure. If the whole building is let to a leaseholder, they may have little motivation to derive additional income from the upper floors, where there may be limited scope for recovering the renovation costs on a short lease. Although the owner may take a longer-term perspective, many seem content with collecting the commercial returns. Commercial leases are often drafted so that any improvements to the property made by the tenant are irrecoverable from the landlord.

The underlying financials of the private rented sector – in particular, the disconnection between rental return and a property's capital value – act as a disincentive for landlords to invest large sums in renovation. Reaping back the investment through rental yields can be a long-term prospect, if a prospect at all. This may well be one area, therefore, where targeted government concessions could make a substantial difference.

The government has already made an attempt in this direction. In response to the

2 The UK's largest provider of student accommodation

recommendations of the Urban Task Force, the 2000 Budget introduced measures to provide 100% initial capital allowances on the costs of refurbishing and adapting premises above commercial properties for residential use. This concession has not, however, been widely used. This can be put down to a lack of publicity and a low level of awareness, the inherent complexity of the allowance and the difficulty of satisfying the governing criteria.

The 2001 Budget introduced further measures to reduce the VAT rate to 5% (against the standard of 17.5%) for renovations and conversions that involved bringing property back into residential use (such as renovating a multiple-occupancy dwelling that has been empty for three years or converting a non-residential property into bedsits or a care home). The existing zero rate for conversions of property that are already residential was also extended to sales of empty renovated houses with the requirement for the developer either to sell or grant a long lease. It is not, however, apparent that these schemes have made much difference to the financial attractiveness of undertaking costly repair schemes, with the latter in particular being hampered by the inability of developers to retain the property for shorter-term lets.

Policy recommendations

As with many cases of government intervention, this has been a case of too little and too restricted to make any real difference. What is needed, in order to make a real inroad into the number of empty and uninhabitable properties, is a much bolder set of measures. These must be aimed at encouraging the private sector to invest in refurbishment by creating the conditions in which the sector can make a reasonable return. There is no easy answer and certainly no one silver bullet, but for a start government and industry might try some or all of the following.

First, in order to encourage investors to put their money into residential property of all types, including that which needs substantial renovation, an appropriate collective vehicle must be made available. The property industry has long argued that a real estate investment trust (REIT) would be ideal since, in its listed form, it ensures an appropriate degree of public scrutiny and accountability. There would also be benefits, however, from a residential market of unlisted REITs, which have less stringent and costly start-up requirements. This would facilitate investment on a smaller scale in a portfolio of residential properties, including that which may be in need of considerable refurbishment, and which may prove higher-risk.

Second, the economics of the market clearly illustrate that unless sufficient financial incentives are put in place, such property will remain empty or rented out at low yields. Government assistance is required to bring older unimproved property, including that above shops, up to the standard where it could form part of an institutional residential portfolio. The limited impact of the fiscal incentives introduced in the early part of the decade show that adjusting minor, but complex and little understood, concessions will not work.

A suite of incentives that make it worthwhile for an owner to invest in the necessary adaptations to bring such properties into use is unlikely to cost more than the equivalent level of housing grant necessary for registered social landlords to subsidise social housing. Changes to VAT or capital allowance regimes offer the most effective way forward – and in the latter case, perhaps the option of offsetting all capital improvement costs against tax. Whatever changes are made, these must be easy to administer and should not deter take-up on account of over-complexity or draconian qualifying rules.

Third, the government needs to present a clear message that it does want to tackle the issue of underutilised and vacant property, not just through a fiscal incentive package but through policy guidance to local authorities and active support through organisations like the Empty Homes Agency. Well-resourced campaigns operating at the local level will be necessary just to get this issue on to the radar.

Fourth, local authorities should make better use of their existing powers, particularly compulsory purchase, which can help unlock renovation opportunities. Most large investors will not get out of bed for single units. They require sizable lots where an impact can be made, not just financially, but also in terms of what they can create. There are a growing number of developers that have made a success out of buying up and converting low-grade accommodation into award-winning homes. The development at Chimney Pot Park in Salford by Urban Splash is an illustration of what can be done. Investors need a better understanding of the economics of such projects and of what can be achieved, while local authorities need to consider how better use of their compulsory purchase powers can help deliver similar opportunities.

Finally, both central and local government need to be mindful of the impact their regulatory interventions have on the viability of projects. Too taxing requirements for affordable housing will ultimately make some projects uneconomic, when, with a little more flexibility, they could create a win-win situation.

In a recent example of this, a BPF member was seeking to renovate an old shop with residential potential above into a block of three flats for rental. Because this was in rural Cornwall, the local authority asked for one flat to be given as an affordable housing requirement. This made the project uneconomic. All three flats would have been let at rents far more affordable than anything that the average household could buy in the area. If the authority had instead asked for a long-term nominations agreement for the flat concerned, the project would now have been delivering three "affordable" homes. As it is, the developer decided to convert it into a large single dwelling, with no "affordable" requirement, which will be sold with the possibility of the excess capacity being used for bed and breakfast accommodation for tourists.

Making the most of what we have

In conclusion, notwithstanding the paucity of hard data and the difficulty of determining the precise numbers involved, the evidence that is available suggests that there are a substantial number of properties, either empty or underutilised, that could be brought back into use for household occupation. The lack of any coherent policy for achieving this, and in particular the absence of any meaningful financial incentive, mean that a potentially valuable source of additional housing is being ignored. Given the current housing supply crisis, this represents a huge opportunity lost. This issue must be addressed for the sake of those in need of housing and in the interests of making the most of what we already have.

Chapter 8

Time to regulate

Lord Richard Best OBE

Time to regulate

The Housing & Regeneration Bill was debated in the House of Lords in April. The bill incorporates arrangements for a new, independent regulator of rented housing. This regulator – Oftenant, the Office for Tenants & Social Landlords – will not cover those living in the private rented sector. It will embrace the tenants of housing associations and other landlords providing social housing; and in a couple of years it is intended that similar regulation will cover the tenants of arm's-length management organisations and of local authorities. The private rented sector is excluded.

At the end of 2007, the then Minister for Housing and Planning, Yvette Cooper, announced a review of the private rented sector and subsequently Dr Julie Rugg and David Rhodes from the University of York were appointed to undertake this. The review is expected to conclude this autumn.

Also in the pipeline is a separate review, instigated by the Royal Institution of Chartered Surveyors and led by Sir Bryan Carsberg, looking at regulation of property transactions in the different tenures, which is likely to cover some similar ground. This review, however, is unlikely to report before the Housing & Regeneration Bill completes its passage through parliament.

To avoid a hiatus between the government receiving clear guidance from external, independent sources and legislative action being taken, this paper concludes that now is the time to act. It argues for enabling powers in the Housing & Regeneration Bill so that all tenants, in the different sectors, can be covered (albeit in different ways) by a regulatory regime. It may be many years before another housing bill provides the opportunity for new legislation.

Inconsistency between landlords

The first argument for a regulatory regime that can cover the private rented sector, as well as social landlords, is that there should be more consistency – a level playing field – for tenants, irrespective of the legal status of the owner of their home.

There is already a chasm between the arrangements for the tenants of housing associations or local authorities and tenants in the private rented sector. This gap will get even wider after the introduction of Oftenant – yet whether or not a household finds itself renting from a social landlord or a private landlord can be a matter of chance. In many places there are properties side by side – including in new mixed-tenure developments – where a housing association owns some of the flats and private landlords own the neighbouring flats. It is anomalous that tenants in adjoining properties enjoy such divergent levels of consumer protection.

The regulatory regime for housing associations is extensive. The Housing Corporation registers each social landlord, requiring certain standards from the outset; it monitors each association's governance and financial management, using a regulatory code; it awards red, amber or green "traffic lights" and publicises the performance of each organisation. In cases of misconduct or mismanagement, the corporation can dismiss the housing association's board and appoint new members. The role of the regulator is extensive and, where the need arises, potentially highly intrusive.

Registered social landlords are also subject to inspection, on behalf of the regulator, by the Audit Commission, which looks at the full range of activity of each housing association. Unsurprisingly, the organisations that are subject to this level of scrutiny will often complain that it is extremely time-consuming and costly. The outcome, however, is a very full understanding of the strengths and weaknesses – and a very strong influence on achieving the highest standards – for each registered social landlord.

Of course, the tenants of local authorities also enjoy extensive protection and councils are subject to comprehensive performance assessments. Tenants have recourse to their local councillors, as well as to one of the three local government ombudsmen.

Professor Martin Cave from the Warwick Business School published a report in 2007 on regulation for the social housing sector, and his recommendations have been taken to heart in the Housing & Regeneration Bill. It is likely that the new Oftenant regulator will follow the advice of Professor Cave in seeking to ensure increased engagement of tenants in the management of their homes (as also recommended in the National Consumer Council's report, commissioned by the National Housing Federation, published in the same year). So the likelihood is that the devolution of power from landlord to tenant will increase as the new regulatory regime goes forward. The gap between the position of the tenant in the private rented sector and in the social housing sector is set to widen still further.

Inconsistency between sectors

Inconsistency not only relates to the different treatment of tenants of different landlords but to the treatment of those in the private rented sector compared with other consumers of services in the private sector. As Dr Biles, the Housing Ombudsman, has put it:

In all of their other dealings as consumers, they will be used to a justified expectation of redress by means of extensive, well-publicised, mainly statutory rights of protection entitling them to their money back or to replacement of faulty articles. When the defective product is their home, however, tenants discover that the same reasonable expectation of redress is not realised.

It is strange that the Consumers & Estate Agents Redress Act 2007, which provides for an ombudsman service and redress scheme that will be compulsory for all those wishing to operate as an estate agent, does not cover letting agents. The management of many properties in the private rented sector is in the hands of agents to whom the landlord has given considerable discretionary power. Where this means professional management of property owned by an investor with no particular knowledge of landlord-and-tenant law or competence in property management, the use of letting agents is an entirely positive arrangement. Without any regulation, however, anyone can set up as a letting agent overnight and the tenants in the properties they manage will have no recourse to any ombudsman service or redress scheme.

Injustice

The consequence of the inconsistent treatment of tenants of private landlords, compared with other tenants and other consumers, is the possibility of injustice.

A tenant with a grievance might try to persuade the local authority to take action under the Housing Act 2004 – using its environmental health officers to inspect the premises and issue notices – if there are failings in the physical standards of fitness. Leaving aside the fact that many authorities are finding it hard to muster the resources to implement the act energetically, powers under the legislation relate to a relatively small part of the total picture.

What if the central heating fails to work and the landlord simply suggests the tenant buys an electric fire? What if condensation is a severe problem and minor repairs are never done? What if the landlord's tenants in the neighbouring property are the cause of intolerable noise and disruption and the landlord does nothing about it? Indeed, what if the landlord simply never replies to any letters?

The only recourse for the average tenant is to take the landlord to court. This is a major undertaking, requiring substantial resources, with a very uncertain outcome if application is made for legal aid.

Furthermore, the potential injustice caused by the absence of consumer protection for the private tenant can run deeper. Under section 21 of the Housing Act 1988, the landlord has the right to evict a tenant, and the court has no discretion to reject the landlord's application. Tenants who complain can see their tenancy terminated on the simple basis of retaliatory eviction.

Any kind of complaints, redress and ombudsman service would be undermined if landlords continue to be permitted to evict the complainant. With such a deterrent hanging over them – irrespective of the number of cases of retaliatory eviction – how many tenants would raise questions about the bad behaviour of their landlord?

The bottom line, in the case for regulation of the private rented sector, is the opportunity – confirmed in practice by Citizens Advice cases up and down the country – for injustices that are unacceptable in a civilised society.

Investment

The reason those concerned with the private rented sector – from politicians to pressure groups – have done little to press the case for regulation is the fear that this would deter investment in private renting. For many years, the UK's private rented sector was the smallest of any EU country, and many attributed its decline to the requirements of the Rent Acts (particularly those introduced immediately after the First and Second World Wars to prevent exploitation of tenants at times of acute shortages).

It was the lifting of the controls on rent and on the prohibition on short-term lettings in the Housing Act 1988 that led directly to the growth – after decades of decline – in the sector. From a low of less than 9% of the nation's housing, the stock of the private rented sector is now around 12%.

Over the past six or seven years, investment in private letting – a good deal of it through buy-to-let mortgages – has reached some £120 billion. In place of anxieties about an absence of funds for the private rented sector, the concern of late has been that too much money is chasing the available properties. This, in turn, has an impact on the ability of first-time buyers to acquire a home. Indeed, the other side of the coin to the dramatic growth in private renting has been a sharp decline in the proportion of new homes purchased by first-time buyers (down from 40% to 25% during this decade). Fears of inhibiting private investment are no longer an issue, and concern that better regulation will "frighten the horses" now looks far-fetched.

Institutional funds

The missing ingredient in the UK's private rented sector is that of funding by the major City institutions. The sector relies on individuals – mostly amateurs and some speculators – investing their City bonuses or making alternative provision to their pensions, alongside overseas investors. Noticeably absent are the big pension funds and insurance companies.

The question here is whether the prize of attracting these institutions – which bring stability, long-term investment and the high standards that come from protecting their national reputations – would be *easier or more difficult* to achieve if the sector were subject to regulation.

A recent president of the British Property Federation, Trevor Moross of property company Dorrington, believes that corporate landlords would be attracted by regulation which "brings clarity, removes suspicion, can engender confidence and can help avoid disputes".[1]

In the 1990s the Joseph Rowntree Foundation set out to establish the basis for a revived private rented sector, at a time when the sector was at its lowest ebb. The foundation invested its own resources in building apartment blocks to high architectural standards, for the new market of single people in their 20s and 30s who were not yet willing or able to become homeowners. The developments built by the JRF in Leeds and Birmingham demonstrated the considerable demand for good-quality rented homes and showed that investors could obtain higher returns than from comparable investment opportunities.

A core objective of this exercise was to impress upon financial institutions that the time was right for substantial investment – similar to that for commercial properties – in residential letting. Economies of scale are achieved by sustaining the sole ownership of a single block. Since rents tend to rise in line with earnings, rather than with the retail price index, returns can match the commitments of those running pension funds.

The JRF experiment did show that an unsatisfied market existed and may have helped to promote the subsequent expansion of buy-to-let. The large-scale investment institutions, however, did not pick up this challenge. Among the reasons was a fear that the sector

1 Bill, P (ed) *More Homes for Rent* (Smith Institute, 2006)

brought with it reputational risks; it was described as "full of cowboys" by one potential investor. This suggests that Trevor Moross is right in expressing an appetite for the sector to be placed on a proper "vendor-customer" footing, as a mature service sector. The big City institutions are well used to regulation, both through the Financial Services Authority and in respect of the different industries in which they invest. For such investors, comparable regulation would be an incentive, not a deterrent.

Inherent deficiencies

The private rented sector is always likely to be an unsatisfactory solution to the housing problems of low-income households looking for a long-term home. On the one hand, because of the price of land and property in this country, rents are going to be very high in relation to earnings, forcing those with more modest incomes to seek state support through housing benefit (and through local housing allowances in the future). Lower rents – as in social housing – reduce dependency on any benefit, removing a barrier to employment. On the other hand, because landlords must always have the opportunity to achieve liquidity for their investment, and get their money out again when they need it, the landlord cannot be expected to grant lifetime security of tenure – although that is just what families need who wish to settle in a community while the children grow up.

There are inherent deficiencies, therefore, in the role of the private rented sector for families on moderate incomes. But these inherent deficiencies do not extend to more mobile, childless and single people on above-average incomes. For them, the ties of home ownership and, indeed, the transactional costs of buying and selling make private renting a preferable alternative to home ownership. In many cases, it will be a cheaper option.

Since this group has grown with demographic change, with couples settling down later in life, with more divorce and separation leading to smaller households, a strong and healthy private rented sector is of national importance. Without it, the only homes for rent are those provided with public subsidy, and there is a finite limit on the scale of provision by social housing landlords at a time of some economic uncertainty. For the sector to prosper, however, it needs to accept a regulatory regime that addresses current inconsistencies and injustices.

Insiders' support

The Association of Residential Letting Agents, the National Association of Estate Agents – which in turn supports the Ombudsman for Estate Agents – and the Royal Institution of Chartered Surveyors have come together to promote the National Approved Letting Scheme, which accredits lettings and management agents and gives reassurance to landlords and tenants that they are in safe hands. Such accreditation provides the basis for a complaints and redress scheme by establishing the criteria against which standards of service can be judged.

Very shortly, it will be impossible to act as an estate agent without being signed up to a full-scale complaints, redress and ombudsman scheme. Already more than 80% of estate agency offices are signed up with the Ombudsman for Estate Agents. This provides a model for handling consumer complaints – with its guidance for the consumer, its code of practice, its ability to award compensation to consumers that have suffered, and the consequent pressure for higher standards of service.

These initiatives from inside the private sector provide pointers to the direction in which a regulatory framework for the private rented sector could be devised.

The great majority of letting agents, however, are not part of any such redress or accreditation scheme. And almost none of the over 500,000 private landlords have voluntarily joined the Housing Ombudsman scheme.

Last year's Law Commission report by Professor Martin Partington, *Encouraging Responsible Letting*,[2] called for a central, independent regulator for the private rented sector. This would ensure that landlords and agents were members of accreditation schemes and/or professional bodies, which would enforce approved codes of practice and disciplinary procedures. The new Office for Tenants & Social Landlords envisaged in the current bill could fulfil the role proposed by the Law Commission.

So the scene is set for the changes that are needed.

In conclusion

It seems astonishing that the private rented sector – a multi-million-pound industry that profoundly affects the lives of millions of consumers – has no regulator, no ombudsman and no redress scheme. Following the buy-to-let boom, there are now hundreds of thousands of landlords who have not had to pass any tests of competence, demonstrate any knowledge of landlord-and-tenant law, or prove their honesty, financial probity or absence from criminal convictions, let alone have any experience of property management. Any drug dealer can set up overnight as a landlord, or indeed as a letting agent.

2 Partington, M *Encouraging Responsible Letting* (Law Commission, 2007)

While the Housing Act 2004 contained modest steps to improve physical conditions in the worst stock, primarily among houses in multiple occupation, it did not address the management of privately owned properties. It is here that tenants can face the most problems, with no means of combating injustices except through complex and costly recourse to the courts. Moreover, tenants who do take their landlord to task can be the subject of retaliatory eviction: unscrupulous landlords can simply terminate the tenancies of those who complain.

Meanwhile, bad landlords are deeply unpopular with the relevant professional organisations and reputable trade associations: these are keen to promote sensible codes of conduct and schemes of accreditation. The absence of compulsion, however, means bad landlords simply refuse to join. As Trevor Morross has put it: "In the private rented sector, the good get better and the bad don't care."

The reason for the lack of regulation for the private rented sector in the past has been a deep concern that this would deter much-needed investment, especially from big financial institutions. The world has since changed. Billions have been invested in recent years, much of this through buy-to-let mortgages. Although this has led to growth in the private rented sector – from approximately 9% to 11% of the nation's homes over the past decade – and soaked up the backlog of demand from mobile young professionals, it has also been inflationary and has priced out a lot of first-time buyers.

Discouragement for more speculative amateur landlords unwilling to adopt industry-wide good practice would be a positive outcome from introducing proper regulation to the sector. Long-term, stable funding from major financial institutions is more likely for a sector that is properly regulated.

By good fortune, a legislative opportunity now exists to incorporate into the Housing & Regeneration Bill an enabling clause that would allow the private rented sector to be brought within the remit of the new Oftenant regulator. Models already exist for industry-wide accreditation, with an accompanying code of good practice, which the regulator could endorse. Models also exist for a consumer complaints, redress and ombudsman scheme to ensure compensation for tenants who are badly treated, placing pressure on all landlords to achieve higher standards.

Now is the time to act.

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