

The revival of the private rented sector

LSE London HEIF workshop

14 April 2011

This workshop was the first in a series of three events focusing on the lessons the UK can learn from those countries where the private rented sector houses a larger percentage of households about how to achieve and maintain a sustainable PRS. The workshop was held at LSE, and was attended by 22 participants from academia, government and industry (lenders and investors). The objective of this first seminar was to identify those attributes of the UK PRS where international experience might be relevant.

The discussion centred around the following points:

The UK's private rented sector

- *Size:* The private rented sector in the UK is smaller than in many other European countries, but in recent years has grown faster than in any other European country apart from Ireland
- *Determinants of growth:* Government did not directly bring about this growth (though it welcomed it). Rent regulation was lifted in 1988, and there was some relaxation of the planning regime. Demand for PRS accommodation increased in the late 1980s and early 1990s as a result of the economic downturn and increased migration and mobility. This rise in demand was in turn associated with the introduction of buy-to-let mortgages. Strong house-price growth in the late 1990s supported speculative investment in the hope of capital gains. Developers responded by increasing construction of the kinds of units that appealed to BTL landlords and which were often bought off plan.
- *Demographics and security of tenure:* One part of the sector houses the young, the mobile and migrants. For such households long-term security of tenure is not a high priority. Another other part of the PRS houses low-income households. For them, and for the increasing number of households with children living in the PRS, security of tenure is an issue. Although longer leases are permissible in the UK they are rarely used—partly because BTL lenders only allow assured shorthold tenancies of 12 months or less.
- *Household preferences:* Although there is now much less stigma about renting privately, few British households genuinely prefer to do so over the long term. Many are forced to remain in the PRS for longer than they wish because even though they could afford monthly mortgage payments, the deposit requirements for entering owner-occupation have become too onerous, particularly in the wake of the global financial crisis. Some studies show that this is even affecting the fertility rate, as people delay starting a family until they can afford to buy a house. It is not clear whether this will affect a cohort into the longer term or result in longer-term behavioural change for future cohorts.
- *Institutional investment:* The amount of institutional investment in the sector remains small, despite a series of government initiatives. Yields are not high enough to attract institutions without big tax breaks, and in any case institutions are interested only in certain types of market—particularly specialised markets such as student housing, and deep urban rental markets where demand is high. International evidence suggests that this is not unusual across many other countries. Institutional investment is a relatively small part of most PRSs (see below). Large blocks where a brand can be created are more attractive than dispersed housing. Participants felt that changing the identity and corporate form of landlords was less important than promoting an overall increase in the amount of housing, and ensuring that all landlords maintained their properties adequately.

- *Overall amount of housing:* Increasing the attractiveness of the PRS to investors of all sorts should lead to an increase in new construction – which could help the country address the chronic shortage of housing. At the moment developers face serious funding constraints which are limiting production.
- *Maintenance:* Demand for rental properties is high, so landlords can get away with poor maintenance. In addition, many individual BTL landlords maintain their properties themselves in order to save money, despite lacking the skills to do so properly. Enhancing security of tenure could worsen this problem, as landlords would have less incentive to invest in their properties if tenants had indefinite leases.
- *Timescale:* Short-term issues must be distinguished from longer-term trends. Will incremental change lead to permanent shifts?

Some observations about international experience from presentations by Michael Oxley and Peter Kemp and subsequent discussion:

- *'Path dependency':* Housing systems are highly path-dependent (we use this term loosely as compared to sociologists), and policies that work in one country may not transfer easily to the specific legal and cultural context of another. On the other hand, looking at other countries' experience sometimes shows that policies dismissed as beyond the pale in the UK are in fact fairly common elsewhere. In particular in the UK, we assume that rent regulation and strong security of tenure are incompatible with a healthy PRS, as respectively they limit landlords' current income and capital gains. Is this borne out elsewhere? If not, does this reflect policies with respect to the PRS, or the treatment of other tenures?
- *PRS as social housing:* In some countries the PRS houses the types of households that would be in the social sector in the UK. This may be because there isn't much social housing to speak of (USA), and/or because governments intentionally use part of the PRS in this way (Germany; France). In return, landlords receive subsidies and tax incentives (Germany, France, USA).
- *Rent regulation:* Many if not most countries control rents to some degree. Often initial rents are freely set but increases are controlled – either in relation to the dwelling or the tenant. Such control of rents often goes hand-in-hand with high security of tenure.
- *Security of tenure:* The prospect of capital gains attracts many PRS investors in the UK. Greater security of tenure is therefore held to be incompatible with increasing the attractiveness of the sector, as it would limit the ability of landlords to realise capital gains at the time of their choice. Security of tenure is in fact higher in many countries that have larger private rented sectors than the UK's—but in drawing comparisons it is also important to look at whether the tenure is growing (as in the UK) or shrinking.
- *Taxation of landlords:* In many countries, the tax systems treat individual landlords more favourably than in the UK. Three policies in particular are common: depreciation allowances, permitting losses from rental investment to be offset against other types of income, and exemptions from or phased reductions in capital gains tax (to encourage long-term investment). In the UK losses from holiday lets can be offset against other income but not losses from general rental property—why not? Another anomaly is that those who take in lodgers can get £4250/year in rent tax-free, but other types of landlord cannot.
- *Fixed-tenure dwellings:* In the UK, all private sector dwellings are built as simply private – the type of unit, mortgage rules and demand together determine whether the dwelling is initially rented or owned. Any private-sector dwelling can move immediately and freely

between owner-occupation and private rental. But in some countries strong regulations identify initial tenure and prevent the division of ownership of multi-dwelling blocks—thus ensuring that they remain in private rental. The government is now backing construction of some pilot ‘build-to-let’ (mass private rental) developments, which represent a major change in the UK housing development model – but the fundamental capacity to change tenure remains .

The next workshop in the series, to be held at LSE on 2 June 2011, will focus in more depth on international experience. Experts from Anglo-Saxon and European countries will attend, and we will report the results of a survey of international housing experts.