

Rebuilding the rented sector in the UK; The role of Buy to Let and Build to Rent and Housing Associations

Peter Williams, CCHPR, Cambridge

My presentation

- Time of unparalleled change and uncertainty generally
- And not least with respect to UK housing markets
- My task is reflect on the recovery of the private rented sector and within that the role of BTR and BTL
- Looking closely at investors/developers and government/regulatory roles and shifts in consumer preferences
- Conclude with a forward view

A world of change – potted version!

- Up to 1990s PRS was in long term decline –falling from 90% of homes in 1914 to 10%. Expectation (mine!) was it would basically disappear!
- Squeezed out by rise of home ownership to over 70%, social renting, consumer preferences/capacity, access to mortgage finance and government policies – clearance, rents, support for submarket renting
- Assured shorthold tenancy with limited security of tenure was introduced by the Housing Act 1988
- 1990s creation of Buy to Let mortgages by industry fuelled an investment demand which previously had relied on cash/commercial finance

A world of change – potted version!

Programme	
Business Expansion Scheme (1983-1993)	<p>Gave tax incentives to private investors who provided venture capital for unquoted companies, initially for a minimum of five years. It was not targeted specifically at housing or the property market, but in 1988 the Government chose the BES as a means of underwriting landlords' risks and encouraging the revival of private renting by extending its provisions for a limited period to companies letting residential property on assured tenancies (Hughes, 1995). The biggest success story—though not intended by the government—was purpose-built student accommodation, which accounted for about 40% of BES-sponsored units. Supported by BES and de-risked by universities and housing associations, it provided guaranteed long-term income growth for institutions. It is now a successful unsubsidised market-based product.</p>
Housing Investment Trusts (1996)	<p>HITs were established in 1996 to provide vehicles for financial institutions to invest in the private rented sector, but none were ever established. The trusts were not fully tax-transparent, the rules governing them did not reflect the normal operating practices of property companies, and the diffuse structure of the PRS at that time was also an obstacle (Crook and Kemp 2002).</p>
Real Estate Investment Trusts (established 2007; rules revised 2012)	<p>In 2012 the Government changed the rules around REITs in order to encourage the establishment of new REITs, notably residential REITs. These changes included the elimination of the requirement that REITs have full Stock Exchange listings and the abolition of the 2% conversion charge on assets. Even after these changes, though, few residential REITs were established.</p>

The onward march of BTL

- Became a significant lending market (see table).
Surge in Q1 2016 then fall away
- Sustained growth and low losses including the GFC
- Decline of other investment opportunities whether as individuals or corporates
- QE partly to blame!
- However both BoE and HMT identified BtL as a risk to market stability –arguing landlords were squeezing out FTBs and in a downturn would sell out –evidence for both was limited
- On back of that a number of tax and regulatory changes imposed on BTL/PRS sector – former bears brunt given lenders are regulated

Table MM17

New and outstanding buy-to-let new mortgages, UK (CML)

											Mortgages	Gross
											outstanding	advances
	BTL	BTL	Gross	Gross	House	House	Remortgage	of which	Other	Other	at EOP	in period
	mortgages	mortgages	advances	advances	purchase	purchase		Remortgage			% of all	% of all
	outstanding	outstanding	in period	in period							mtg loans	mtg loans
	number	£m	number	£m	number	£m	number	£m	number	£m	by value	by value
2000	120,300	9,100	48,400	3,900							1.7	3.3
2001	185,000	14,700	72,200	6,900							2.5	4.4
2002	275,500	24,200	130,000	12,900	85,030	8,030	44,550	4,130	410	50	3.7	5.9
2003	417,500	39,000	187,600	20,300	117,120	11,600	69,150	7,460	1,330	140	5.2	7.4
2004	576,700	56,900	226,000	24,100	143,870	14,060	80,490	8,490	1,640	150	6.6	8.4
2005	699,400	73,100	223,100	25,600	120,460	12,630	100,550	11,670	2,080	200	7.7	9.0
2006	835,900	93,200	319,200	38,000	170,830	19,590	145,500	17,120	2,870	280	8.9	11.1
2007	1,025,500	120,600	346,000	45,700	183,280	23,100	155,720	20,640	7,000	860	10.4	12.8
2008	1,168,800	139,200	225,300	28,500	103,990	12,210	114,740	14,610	6,560	820	11.7	11.5
2009	1,246,900	146,600	88,400	8,600	52,600	4,530	32,850	3,390	2,950	300	12.3	6.1
2010	1,309,400	151,600	85,300	9,100	49,400	4,600	35,000	3,600	800	40	12.6	6.8
2011	1,387,800	158,700	114,900	13,100	61,500	6,200	52,600	6,400	800	110	13.2	9.5
2012	1,449,000	164,800	130,200	15,800	69,900	7,400	59,200	7,600	1,300	180	13.5	10.9
2013	1,528,200	174,000	161,000	20,800	83,100	9,300	76,300	10,700	1,600	270	14.1	11.7
2014	1,654,400	190,200	197,700	27,200	100,500	12,400	95,900	14,500	1,300	270	15.1	13.4
2015	1,786,000	213,500	252,200	37,900	117,500	15,600	132,300	21,900	2,400	370	16.7	17.3

BTL

- These include
- Mortgage interest tax relief will gradually be cut back to basic rate 20% between 2017 and 2020 for individuals
- Tax will be deducted on basis of gross rather than net income – shifts tax bands
- Wear and tear will be allowable on evidenced costs incurred rather than notional 10% deduction from profits
- A 3% stamp duty surcharge for landlords purchases was announced in the Autumn Statement 2016.
- Landlords to pay capital gains tax (CGT) on any profits within 30 days of selling a property from April 2019.

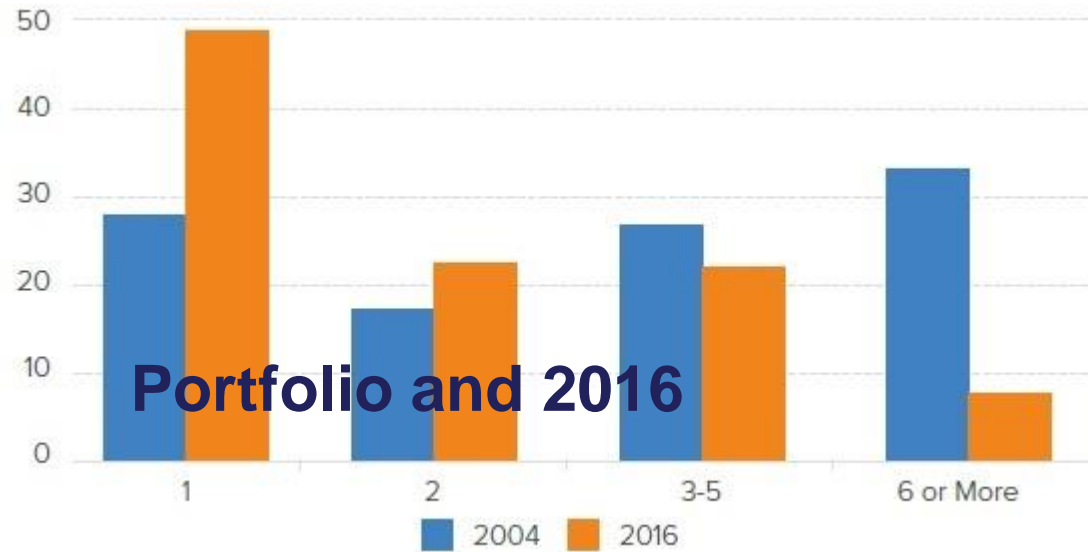
BtL – In addition

- The Financial Policy Committee of the BoE will be able to direct regulated lenders to place limits on BtL lending in relation to: loan-to-value (LTV) ratios and interest coverage ratios (ICRs)
- PRA has imposed a 2% stress test on payrate for loans <5 years
- Affordability assessments should take into account: borrower's costs including tax liabilities, verified personal income (where used by the lender)
- Lending to portfolio landlords (defined by the PRA as being those with four or more mortgaged buy-to-let properties) must be assessed using a specialist underwriting process.

BtL –an update

- Little wonder then that activity levels have shrunk
- Recent survey data <https://www.cml.org.uk/news/press-releases/cml-research-survey-of-uk-landlords/>
- 49% of landlords owned property outright, no mortgage debt
- Over 50% had LtVs on their portfolio of <60%, & only 1% > 90%
- In 2004, only 24% of landlords were aged 55+, 61% in 2016
- 66% earn less than 25% of household income from rent. Around 10% had profitable full-time living from it.
- Nearly 25% renting out property ‘accidentaly’ while around 14% started by providing a home for a relative or friend.
- Over 33% of landlords are offering leases >12 months
- BTL landlords who planned to divest were a net 5% over the next 12 months and 11% over the next five years.

Size (no of units) of BTL landlords, 2004 & 2016



Crossover

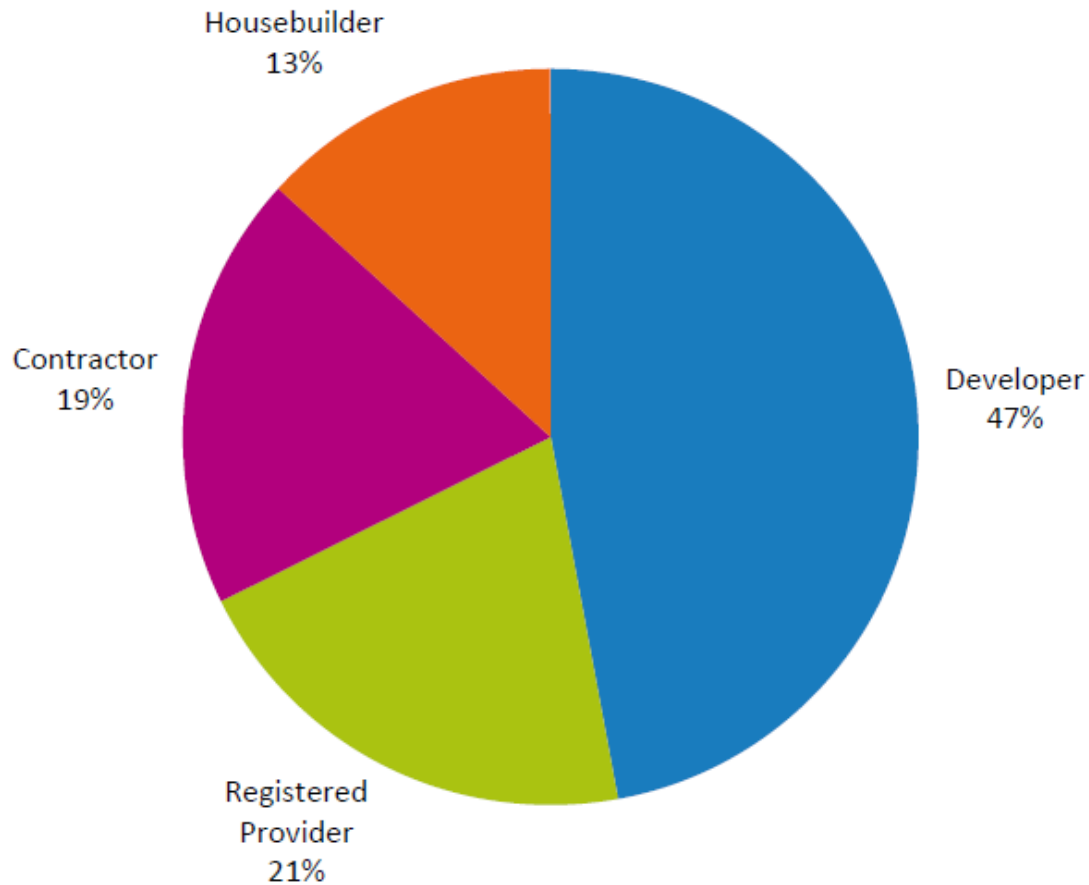
- In reality only about a third of the PRS market is funded via BTL mortgages
- Another third of buyers use cash or inherit the property while the remaining third use commercial loans.
- There is now a growing institutional investment-backed PRS funding the creation of new apartment blocks.
- During 2015 it was estimated some £2.65 billion of funds went into the sector – an increase of 15 per cent over 2014.
- Grainger PLC, the UK's largest listed residential landlord with a portfolio of about 9,000 rental units, is planning to invest a further £1 billion through build to rent.

Build to Rent

- 1930s to 1960s institutional investment in PRS then exit
- 2012 Montague Review of PRS recommended govt support new build for rent
- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/15547/montague_review.pdf
- Build to rent £200/£1bn investment fund (equity or loan finance) kick start new development now in £3bn Home Building Fund <https://www.gov.uk/homebuildingfund>
- >5 years for development finance, and < 20 years for infrastructure; interest is payable
- £3.5 bn govt loan guarantee fund also set up to help investors hold rental property . Slow start. Rent for 10 years then sell?
- Housing associations in both schemes
- Rising prices pushed down yields

Build to Rent

Figure 5 – Completed PRS Schemes by Type of Deliverer, England and Wales



Source: Moliar, Glenigan, BPF, Savills

Build to Rent

- BTR can deliver homes at 2.5 times the speed of sale developments . There's £10bn of firm commitments/£30bn ready to invest by 2020
- BPF suggests 12,000 PRS units owned by institutions in the UK and further 66,000 in pipeline.
- BTR will contribute to the UK's new housing supply, and at a mid-market price point to match some local housing need.
- But a much lower annual rate of return is generated by BTR (7.5% pa) compared to sales model (17.5%). With development risk investors/developers look for between 10% and 12.5% pa
- Local authorities need to offering planning obligation flexibility/favourable public land pricing



Build to Rent; the basics for institutional investors issues

- a suitable stock of purpose-built units to allow cost efficient management and provide
- flexible accommodation for tenants;
- rents that rise with tenant incomes, so matching the structure of the institutions' outgoings;
- the assurance that they can gain repossession if the tenant fails to meet the terms of their contract; and
- a stable tax and regulatory framework.
- Plus institutions normally do not take on development risk, and try to avoid both reputational and policy risk.
- Thus the window for housing associations as both developers and managers

Build to Rent issues

- Rising prices favour selling new homes rather than renting.
- Section 106/CIL 'planning gain' shrinks viability of large scheme
- Schemes with longer-term tenancies can limit the range of guaranteed exit options/affect a development's value.
- Absence of private landlords with large portfolios often limits the scale, quality and consistency of the rental product.
- Institutional investors want portfolios with >1,000 units of a standardised, high quality to ensure operating efficiencies
- Scale of past activity yet to give reliable information on returns across a defined asset class (net yield of >5% is required).
- Doubts rental yields can be achieved compared to other investment options.
- Concerns about potential high management costs
- 'Best consideration' requirement for public sector landowners tends to result in a preference for sale.
- Chronic lack of suitable land for development and NHB (providing £8k per house for LA) may not be enough in London.
- Lengthened duration of tenancies reduce churn and decrease 'liquidity'

Build to Rent issues

- No suggestion at this stage that this new market will take over and revolutionise the mainstream rental market
- However, it is clear there is considerable investor/developer appetite and it has a momentum not seen before.
- L&G (£600m with PGGM), M&G, Hermes, Invesco (£250m), La Salle (£500m), Gatehouse (£100m)
- New report by BPF/Savills
http://www.savills.co.uk/_news/article/72418/214102-0/02/2017/bpf-and-savills-launch-debut-report-for-build-to-rent-sector
- Government White Paper on February 7 outlined proposals for longer term tenancies and planning reform to include BTR
- <https://www.gov.uk/government/news/government-announces-ambitious-plan-to-build-the-homes-britain-needs>
- Total amount of institutional money committed to PRS since the start of 2016 to more than £1bn — driven by insurance companies and pension funds seeking long-term steady rental yields.

Build to Rent BPF report

- BTR Definition - A statutory planning definition will help accelerate and maximise delivery of homes.
- Discounted Market Rent – NPPF should identify that discounted market rent is an acceptable form of affordable housing.
- Covenants and Clawbacks – NPPG on the use of covenants to ensure local authorities are using consistent clawback mechanisms.
- Planning Preference for Build-to-Rent on Large Sites – recognise the significant additionality benefits of BTR to bring forward phases of large sites
- The Government should consider extending the £3.5bn Debt Guarantee for PRS to give confidence to lenders that there will be investment / end buyer finance to help the market scale up and mature.
- Home Builders Fund – an explicit tranche of the Home Builders Fund for PRS
- Market Information and Transparency – make range of information and data on the new BTR sector available
- Exempt large scale investors from the 3% SDLT surcharge.
- Changes to the VAT regime in terms of zero-rating the costs of repairs and maintenance.

Conclusion

- Question of alternative investments? Brexit?
- PRS likely to remain dominated by small private investors who have bought existing properties, as in most other countries.
- The fact that the PRS is now in play in political and policy terms is of some concern for institutional investors as well for the small investor, because they are committing substantial funds for the long term in order to fund other liabilities, e.g. pension payments
- However both BtL and BTR have significant roles and provide a reasonably firm basis for the PRS over the longer term
- And one that is ever more competitive and with higher quality
- But neither solve the housing problem/both generate new tensions, BTR focus on flats/top end; BtL competes with FTBs
- A real challenge to home ownership –rent better than can buy?

References

- <https://www.pwc.co.uk/assets/pdf/ukey-section3-housing-market-july-2015.pdf>
- <http://www.centreforlondon.org/wp-content/uploads/2016/08/Future-of-Londons-Market-Rented-SectorFinal.pdf>
- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81460/consult_investment_ukprivaterentedsector.pdf
- <http://www.bpf.org.uk/sites/default/files/resources/BPF-Build-to-Rent-Welcome-to-the-UKs-newest-housing-sector.pdf>
- http://www.socialfinance.org.uk/wp-content/uploads/2014/07/The_challenges_of_build_to_rent_.pdf
- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/558849/An_introduction_to_the_home_building_fund.pdf
- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/568478/160105_Proposed_Scheme_rules_changes_update_.pdf
- http://www.lselondonhousing.org/wp-content/uploads/2016/10/Understanding-the-Role-of-Private-Renting_Web.pdf
- <http://www.ipf.org.uk/resourceLibrary/mind-the-viability-gap--achieving-more-large-scale--build-to-rent-housing--september-2015-.html>