Building the new private rented sector: issues and prospects (England)

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Summary

This briefing paper sets out measures taken by successive Governments, and policy proposals from those within the private rented sector, to increase the supply of privately rented properties in England.

Since 2011 private rental has been the second largest housing tenure in England behind owner-occupation, overtaking social housing. In the context of this growth over the last 20 years, and in the context of a national shortage of housing stock, successive Governments have increasingly looked to the private rented sector (PRS) to play a greater role in providing more new build housing.

The 2010 Coalition Government emphasised the importance of increasing institutional investment into the PRS to fund large-scale, professionally managed developments. In August 2012 the Montague review, *Review of the barriers to institutional investment in private rented homes*, was published. The Government accepted a number of its recommendations, which were announced in its *Housing Stimulus Package* in September 2012.

Alongside the 2015 Government’s Housing White Paper, a consultation was launched in February 2017 with proposals to increase the viability of purpose built rental developments (build-to-rent). The proposals also sought to make it easier for planning authorities to consider build-to-rent developments to meet their local housing needs, through updates to the national planning guidance.

Despite the 2010 Government’s focus on institutional investment, the majority of PRS properties in England are currently built, acquired and managed by individual, buy-to-let landlords. This briefing also sets out the Government’s response to policy proposals from smaller landlords to help them boost the national supply of private rented housing.
1. The state of the private rented sector

The private rented sector (PRS) has expanded rapidly in recent years, with 4.5 million PRS properties making up 20% of all households in 2015/16.\(^1\) Knight Frank estimated in 2017 that this would rise to 24% of all households by 2021.\(^2\) In 2011, the sector overtook social renting as the second largest tenure behind owner-occupation.

There has been fairly consistent growth in the sector since the late 1980s. The Smith Institute and Centre for Cities argued this is largely a result of the Housing Act 1988, which introduced the assured shorthold tenancy regime,\(^3\) and by the introduction of buy-to-let mortgages in 1996.\(^4\) Other frequently cited explanations include price and availability constraints on the other two main tenure types, owner-occupation and social housing respectively, and the requirement of an increasingly mobile workforce for a more flexible tenure.

Successive Governments have highlighted the flexibility offered by the sector and its benefit for young professionals and a mobile labour market.

This vision of a high-end and flexible PRS market captures some of the benefits of the sector, however it is not a complete picture. Rugg and Rhodes (2008) identified a number of different renter types, from students to migrants and families priced out of owner-occupation, creating a complex picture of the PRS in England.\(^5\)

Source: DCLG\(^6\)

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3. These tenancies are not subject to rent control and offer no long-term security of tenure.
6. DCLG, *Live tables on dwelling stock (including vacant)*, Table 104, April 2016
Despite recent growth in the size of the PRS, there is debate as to whether this has led to an increase in overall housing stock, or whether the growth has simply replaced developments that had previously been predominantly for owner-occupation (see section 4.1).

The sector remains a cottage industry. The Department for Communities and Local Government’s (DCLG) Private Landlords Survey 2010 showed that 89% of landlords in England are private individuals rather than companies or organisations, 92% of landlords are part-time, and just 2% of landlords have a portfolio of more than 10 properties. The nature of the industry can therefore make it difficult to regulate and to disseminate information, such as legal duties around property maintenance.

The combination of aging stock and the cottage nature of the private rented sector have prompted criticisms of parts of the sector. A 2013 Communities and Local Government (CLG) Select Committee report highlighted particular concerns about security of tenure, property standards and regulation of letting agencies.7

1.1 A sector growing in importance

In the context of a housing supply shortage, there is increased focus on the role the PRS can play in housing people who cannot access social housing and who cannot afford to buy a property. Historically, the PRS has not been a tenure of choice for most people. Concerns, including those around security of tenure and property conditions, as well as the cultural significance put on property ownership in comparison to other European countries, are all factors that have resulted in only 3% of the population choosing to live in the PRS.8 However, this may be changing.

The PRS is viewed as an essential part of a strong housing market; successive Governments have tried to create and promote a more professional PRS that is more attractive to tenants, developers and investors.

The previous Labour Government launched a consultation exercise in 2010 on measures to increase investment in the PRS, identifying it as a key component in increasing the supply of new housing:

The Private Rented Sector (PRS) plays a critical role within the housing system, helping to meet growing demand and providing a flexible tenure choice. It has also played a disproportionate role in funding new-build supply in recent years. It is important that the sector continues to grow and develop to help meet the housing challenge, and that it is able to respond effectively to changing demand.9

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7 Communities and Local Government Committee, The private rented sector, 8 July 2013, HC 50, 2013-14
8 Million Homes, Millions Lives, Nation Rent, 2014
The exercise requested submissions on how to stimulate interest in and increase lending for buy-to-let mortgages, which had been impacted by the economic downturn, to boost individual investment in the sector.

With regards to institutional investment, the exercise called for evidence to justify that this was a viable or desirable way to stimulate the sector:

6.21 It has been suggested that institutional investment will be beneficial, not only in helping to meet growing housing demand, and increase new-build housing supply, but also in encouraging the development of a more ‘professional’ PRS.

6.22 However, the position is not clear-cut. New institutional investment might simply substitute for supply that would otherwise have been delivered through individuals. Additional investment, particularly if geographically concentrated, and/or directed into the existing stock, could be expected to have some impact on house prices. In addition, the previous chapter explained that surveys of tenant satisfaction rates do not appear to support the argument that larger, more professional, landlords will necessarily provide a better service to tenants than individual landlords. The Government is therefore interested in any evidence of the net benefits institutional investment might bring to the housing market.10

Before a consultation response was published, the General Election saw Labour replaced by the 2010 Coalition Government. In its response to the consultation, the new Government argued that significant tax incentives would be necessary to guarantee substantial institutional investment in the PRS. In light of budgetary constraints, the Government ruled out additional financial support to increase the supply of new private sector homes to rent:

3.21 The Government is committed to creating the best possible environment for a sustainable private sector led economic recovery, though the financial position means that priority must be given to maintaining the fiscal base. However, the Government will continue to keep all taxes under review and considers proposals for new reliefs carefully.

3.22 In this context the Government will be considering further the case for changes to the UKREITs regime in order to reduce barriers to entry to the regime and changes to the threshold for rent-a-room relief to encourage better use of the existing housing stock. To the extent that any such changes are likely to carry a cost to the Exchequer at a time when deficit reduction remains the Government’s main priority, these measures will need to be considered in the round, alongside other policy priorities, with any announcement made as part of the 2011 Budget.11

The issue of institutional investment in the PRS was raised again in February 2012 when DCLG published a call for evidence for a review into removing barriers to institutional investment in the sector.

The findings of the Montague review, Review of the barriers to institutional investment in private rented homes, were published in August 2012. The review suggested that an increase in institutional

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investment could tackle some of the perceived historic weaknesses of the PRS, such as:

- The potential to offer longer-term rented homes;
- A better service to tenants;
- Purpose-built accommodation to a high standard of construction.  

The review also argued that given the levels of demand for PRS over home ownership, increased institutional investment could help to unlock stalled sites and therefore increase overall housing stock.

The then Housing Minister, Grant Shapps, described it as a “blueprint” for reform of the PRS. The 2010 Government subsequently adopted a number of recommendations made by the review.

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2. Government initiatives to encourage increased supply

The Government response to the Montague review saw the acceptance of Sir Adrian Montague’s recommendations of a Build to Rent fund, a debt guarantee scheme, and a PRS taskforce (as set out in the following 2013 PQ response):

**Dr Offord:** To ask the Secretary of State for Communities and Local Government what steps his Department is taking to encourage the delivery of more private rented sector accommodation.

**Kris Hopkins:** This Government are committed to a bigger and better private rented sector, which is why, following the Montague review, we have put in place the £1 billion Build to Rent fund, the £10 billion Housing Guarantees schemes, and the private rented sector taskforce.\(^{14}\)

### 2.1 Build to Rent Fund (2012-16)

One of the recommendations in the Montague review was a fund to support new larger-scale developments:

Recognising that institutional interest is likely to be mainly focussed on the take-out of completed and stabilised developments, Government should also consider seeding institutional funds in order to leverage in other private capital. This funding should be on the same terms as private investment, without any element of subsidy, and should be seen as a demonstration, through the power of example, of the Government’s determination to trigger a significant expansion of institutional interest in the sector.\(^{15}\)

The 2010 Government’s Housing Stimulus Package, announced in September 2012, included a commitment to build an “additional 5,000 homes for rent at market rates in line with proposals outlined in Sir Adrian Montague’s report to Government on boosting the private rented sector.”\(^{16}\) These would be funded by a £200 million Build to Rent investment fund.

The Build to Rent prospectus indicated that bids should include at least 100 private rented units and that the fund would not cover more than 50% of costs. These conditions were likely to only realistically be met by large-scale institutional investors.

In the 2013 Budget, there was an announcement of additional funding for the Build to Rent scheme:

**1.108** The £200 million Build to Rent fund announced at Autumn Statement 2012 was significantly oversubscribed. Budget 2013 announces that this fund will be expanded to £1 billion to support the development of more homes in England. The fund will provide...

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\(^{14}\) PQ 176101 [Private rented housing], 25 November 2013.


\(^{16}\) Prime Minister’s Office, *Plans to boost UK housebuilding, jobs and the economy*, September 2012.
equity or loan finance to support the development finance stage of building new homes for private rent.\(^\text{17}\)

The £1 billion fund was intended to build 10,000 new homes for rent. The first round of bidding was significantly oversubscribed, with the Homes and Communities Agency (HCA) announcing that £1.4 billion of bids had been received.\(^\text{18}\) In April 2013 it was announced that £700 million would be set aside for 45 first round bids.\(^\text{19}\)

It was subsequently reported that a large number of developers had withdrawn from the bidding process.\(^\text{20}\) The final allocation for round one was £123 million, with nine contracts awarded to eight developers.\(^\text{21}\) The first contract, for 102 private rental units at Centenary Quay in Southampton, was signed in July 2013.\(^\text{22}\)

Mark Farmer of EC Harris argued that this withdrawal was a result of a recovering homeownership market, which saw many developers involved in Build to Rent divert back to their core business area.\(^\text{23}\)

One of the developers to withdraw was Keepmoat. The group Chief Executive Dave Sheridan blamed “initiative overload,” with Build to Rent affected by the increased liquidity in the homeownership market as a result of Help to Buy, launched in October 2013.\(^\text{24}\)

A second round of Build to Rent was launched in September 2013, with a shortlist of 36 developers announced in March 2014 bidding for the remaining £850 million.\(^\text{25}\) In January 2015 the HCA announced that the remainder of the £1 billion would be allocated through continuous market engagement, rather than opening a third round of bidding.\(^\text{26}\)

Despite this reduction in initial interest, James Coghill of Savills said the fund had been a catalyst for new PRS builds:

> It got a bit of momentum into the market but institutional equity was heading that way anyway, so investors’ demand has probably overtaken [the fund] to some degree.\(^\text{27}\)

In his evidence to the CLG Select Committee report on the PRS, Neil Hadden of Genesis Housing Association, one of the successful bidders, argued that Build to Rent had not affected the number of properties they were building, but did impact on how many of these became private rental units:

> We already own the sites and we were going to develop them anyway. The issue was what tenure mix we would deliver on

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\(^{17}\) HM Treasury, *Budget 2013*, March 2013, para 1.108

\(^{18}\) Homes and Communities Agency, ‘Build to rent round 1’, (last accessed 23 January 2015).

\(^{19}\) DCLG, *Up to 10,000 new homes will improve the rental market*, April 2013.


\(^{21}\) HCA, *Build to Rent: round 1 signed contracts*, June 2015.

\(^{22}\) DCLG, *First rental deal yields hundreds of new homes*, July 2013.


\(^{24}\) Ibid.

\(^{25}\) HCA, *Build to rent: round 2 shortlist*, 5 March 2014 (last accessed 23 January 2015).

\(^{26}\) HCA, *Build to rent fund: Continuous market engagement – prospectus*, January 2015

\(^{27}\) ‘UK rental homes stimulus labelled a failure’, *Financial Times*, 28 July 2014.
those sites. This fund came along, so we said, “Okay, we might as well see whether it works for us”.  

The Committee concluded that the Build to Rent fund should be welcomed, but that the Government should ensure it made “a net addition to new housing, as well as speeding up the delivery of those homes already in the pipeline.”

In October 2015, the then Housing Minister Brandon Lewis gave an update on the Build to Rent fund:

As at the end of September, there were 15 schemes in contract with the Homes and Communities Agency, representing £455 million of investment from the Build to Rent Fund, and which are expected to deliver over 4,000 housing units. In addition, a further 8 schemes seeking up to £378 million of investment have been shortlisted and are undergoing their approval process, potentially delivering up to an additional 2,950 housing units.

Brandon Lewis also sought to argue that the fund had been beneficial for developers who had not been successful in their application:

The Build-to-Rent programme has helped to catalyse funding from other sources. Developers are now proceeding with schemes that will deliver over 3,000 homes using alternative finance after having originally made an application to the Fund.

By March 2016 it was confirmed that construction of 4,500 rental homes funded by Build to Rent had been started.

In October 2016, it was announced that the Build to Rent fund would be rolled into a broader Home Building Fund, with no specific requirements that funding be used for PRS properties. This arguably suggested a change in policy emphasis from the new Prime Minister Theresa May. There are no final figures on how much of the Build to Rent fund was allocated for PRS developments.

However, it could alternatively be argued that the incorporation of Build to Rent into the Home Building Fund was part of the 2010 Government’s original policy intention. Sir Adrian Montague, in his 2013 evidence to the CLG Committee, argued that the financial support should be a targeted, and limited, kick-start to the PRS market, rather than an “enduring subsidy.”

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29 Ibid., p54.
30 PQ 12626, 23 October 2015
31 PQ 24376, 3 February 2016
32 PQ 31838, 30 March 2016
33 ‘Government reveals criteria for £3bn Home Building Fund’, Inside Housing, 4 October 2016
34 CLG Committee, The private rented sector, 8 July 2013, HC 50-II, 2013-14, Ev 22
2.2 The PRS Housing Guarantee

In addition to an investment fund, Montague also recommended:

Equity or debt funding to support schemes that can be sold into the institutional market once completed and which would act as demonstrations of possible viability, particularly around yields.\(^{35}\)

As a result, the 2010 Government announced in its **Housing Stimulus Package** that it would be providing £3.5 billion in housing guarantees to support the building of new homes for the PRS:

The private rented sector housing debt guarantee scheme supports the building of new homes for the private rented sector across the UK, offering housing providers a Government guarantee on debt they raise to invest in new privately rented homes. This will help to reduce their borrowing costs, increasing the number of homes they can afford to provide.

The debt guarantee is designed specifically to attract investment into the private rented sector from fixed-income investors who want a stable, long-term return on investment without exposure to residential property risk. The scheme rules for the private rented sector housing guarantee scheme were published in February 2013.\(^{36}\)

In June 2013 the then Housing Minister, Mark Prisk, announced that the full application process would "open shortly."\(^{37}\) This announcement followed press reports stating that no private company had formally expressed an interest in running the scheme.\(^{38}\)

It was then announced in December 2014 that PRS Operations, a subsidiary of Venn Partners LLP, would be managing the scheme.\(^{39}\) Following this announcement the **scheme rules** were updated. They stipulated that a project must have a minimum value of £10 million, with the loan covering up to 80% of the project’s value.\(^{40}\)

In his evidence to the CLG Select Committee, Sir Adrian Montague indicated the amount set aside for the guarantee had gone beyond what he had anticipated in his report:

**Q114 Chair:** I understand why you have given qualified support to the £200 million build-to-let fund, which is about trying to stimulate a market—trying to get examples going that others can then follow. However, you were absolutely categorical in your review when you talked about being urged to get the Government to provide guarantees of different kinds as a way of stimulating the market. You said, “We do not advocate guarantees of any of these descriptions as they tend to distort the market.” That is pretty categorical, yet £10 billion is hardly a kick-start, is it? It is a massive great wodge of money, and you are quite happy for that to act as a guarantee.


\(^{36}\) DCLG, *Improving the rented housing sector* (last accessed 23 November 2016).


\(^{38}\) "Build to let plans fall flat after investors show scant interest", *Financial Times*, 10 June 2013.

\(^{39}\) DCLG, *£3.5 billion funding boost for new rented homes*, December 2014.

Sir Adrian Montague: I was not concerned with the policy decision to implement the housing guarantee scheme. I conducted the review; I have not had the responsibility of implementing it. I think that was motivated by the desire to stimulate the flow of funding into the sector, beyond what might be achieved by the build-to-let scheme. I think reasonable men can differ on the desirability of guarantees.

Q115 Chair: Right. So you would rather it was done another way?

Sir Adrian Montague: I think it is a step in the right direction; it may be a bound in the right direction rather than the modest step I was envisaging.41

As the scheme had not been launched before the publication of the CLG Committee report on the PRS, it was not able to assess its effectiveness. The Committee requested that the Government’s response provide details on the number of applications received and the number of new homes it anticipated the scheme would produce.

The Government’s response in October 2013 did not provide this information.42 The response did however confirm that in addition to the £3.5 billion, £3 billion extra would be held in reserve either for this scheme or the affordable homes guarantee programme (AHGP), depending on demand.

The £3.5 billion specifically allocated to the AHGP made up the remainder of the £10 billion for housing guarantees often cited by the Government. The AHGP closed in March 2016 with a reported £2 billion of debt guaranteed.43 This could, in theory, leave the entire £3 billion reserve to the PRS guarantee scheme.

Concerns were raised in the CLG Committee report about likely uptake of the scheme. Neil Hadden told the Committee:

There will be a fee that goes to the [Homes and Communities Agency], and there will be a fee that goes to the aggregator. By the time you have totted all that up, with the guaranteed low cost of borrowing it will perhaps not be much different from what we can borrow at anyway.44

Additionally, Savills’ James Coghill said that “the market didn’t really respond to the aggregator role [the Government] wanted to put in place.”45

Mark Prisk told the Committee that even before the scheme was launched, by simply announcing its intentions the Government could have affected the PRS market.46 Outside of the housing guarantee scheme, in December 2014 Venn agreed a £20 million debt

41 CLG Committee, The private rented sector, 8 July 2013, HC 50-II, 2013-14
43 ‘Government to end affordable homes guarantees scheme in March 2016’, Social Housing, 30 November 2015
44 CLG Committee, The private rented sector, 8 July 2013, HC 50, 2013-14, p54.
46 CLG Committee, The private rented sector, 8 July 2013, HC 50, 2013-14, p54.
facility with Essential Living, an institutionally-backed PRS developer established in late 2012.\textsuperscript{47}

It was reported that Venn originally intended to open applications by April 2015 and to issue the first bond to match-fund the loans under the scheme later that year.\textsuperscript{48} However, the first bond, with a value of £265 million was not actually issued until November 2016.\textsuperscript{49}

It was announced in the 2016 Budget that the PRS guarantee scheme would be extended from December 2016 until December 2017, which is likely to be related to the delay in issuing the first bond.\textsuperscript{50}

### 2.3 PRS Taskforce

In order to support developers in utilising these new initiatives, Montague recommended that a PRS taskforce be set up to act as “an enabler.”\textsuperscript{51} The taskforce was established in April 2013.

A DCLG press release stated that the taskforce had helped to identify aspirations to invest over £10 billion of equity in the PRS.\textsuperscript{52} In response to a PQ on the housing guarantee scheme, the then Housing Minister, Kris Hopkins, drew attention to the taskforce’s involvement even before the scheme had been officially launched:

> In relation to the Private Rented Sector Guarantee, we are currently in direct commercial negotiations with a number of borrowers with large enough projects to raise their own finance. The Private Rented Sector Taskforce is supporting this, and the separate Build to Rent fund, by engaging with the market and encouraging key players to invest to kick-start the new private rented sector.\textsuperscript{53}

The term ‘kick-starting’ came up again in the Government’s response to the CLG Committee’s report on the PRS:

> The core mission of the Taskforce is to kick-start the new private rented sector in the UK. This will provide an abundance of good, small scale private landlords but it will be characterised by a growing number of large scale, professionally managed developments, owned and managed by institutional investors and private sector organisations.\textsuperscript{54}

This clearly set out the Government’s interpretation of the ‘new private rented sector’, defined largely by a significant increase in institutional investment.

The taskforce was disbanded in March 2015. The temporary nature of the taskforce was always intended by the 2010 Government, in order to

\textsuperscript{47} ‘Residential landlord signs £20m loan with Venn’, Inside Housing, 19 December 2014.

\textsuperscript{48} ‘Housing associations eye PRS guarantees fund’, Inside Housing, 23 March 2015.

\textsuperscript{49} ‘PRS bond raises £265m at 1.75%’, Inside Housing, 18 November 2016.

\textsuperscript{50} HM Treasury, Budget 2016, March 2016, para 2.296.

\textsuperscript{51} DCLG, Review of the barriers to institutional investment in private rented homes, August 2012, para 54.

\textsuperscript{52} DCLG, £3.5 billion funding boost for new rented homes, December 2014.

\textsuperscript{53} PQ 184930 (Housing bond guarantee scheme), 27 February 2014.

\textsuperscript{54} HM Government, Government Response to the Communities and Local Government Select Committee Report: The Private Rented Sector, October 2013, para 41.
prevent it becoming “just another quango.” However, a permanent position of Build to Rent Champion was created within DCLG following the closure of the taskforce.

2.4 Housing White Paper, February 2017

Alongside the 2015 Government’s Housing White Paper, *Fixing our broken housing market* (February), DCLG launched a consultation on policies to improve the viability of new build-to-rent developments and to attract greater levels of institutional investment. It noted that there remained several barriers to new developments:

The number of new Build to Rent homes constructed is steadily increasing, but the Government has heard from developers and investors that barriers to development remain and that the capital available for investment could be deployed faster if those barriers are overcome. Acquisition of land, the predictability and speed of planning decisions for this emerging sector and the negotiation of planning obligations relating to affordable housing are frequently cited as key barriers.

As a result, the consultation, launched in February 2017, proposed the following policy changes:

- Changing the National Planning Policy Framework (NPPF) to explicitly refer to build-to-rent as a model that planning authorities should consider;
- Allow developers to more easily offer affordable private rent instead of other types of affordable housing;
- Encourage the use of family-friendly tenancies;
- Establish a joint committee of Government, industry and the public sector to help address wider barriers to build-to-rent.

The NPPF was first published in 2012 with the intention of streamlining the planning process and speeding up developments. Sir Adrian Montague commended the “flexible and permissive approach” to planning in the NPPF, although he noted that it needed to specifically recognise the role of the private rented sector.

In 2015, the viability section of national planning guidance was amended to refer to the private rented sector, noting that purpose built developments had different economics to build-to-sale developments. However, the 2017 White Paper proposed going further, specifically referring to build-to-rent, to ensure that planning authorities are “provided with clear policy guidance on how to apply the approach in their plans.”

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56 British Property Federation, *Government confirms it will appoint a ‘Build to Rent champion’*, February 2015.
The consultation document proposed a limited definition of build-to-rent in the NPPF, so as not to be overly-rigid, but suggested characteristics such as tenure mix (typically 100% rented), typology (houses or flats) and management and ownership to be included.

It also proposed including another of the new policy proposals, Affordable Private Rent (APR) in the definition of build-to-rent.

Under the consultation proposals, the NPPF would be amended to make clear that APR could be offered by developers instead of other types of affordable housing required under planning obligations, as this could make developments more viable:

> A big advantage of Affordable Private Rent is that, by combining all of the market and discounted units into a single development under common control, without the separate involvement of a social landlord, efficiencies can be realised in the design, density, construction and management of schemes. These efficiencies improve financial viability. They also enable a greater number of affordable units to be provided in total than would normally be the case for an equivalent scheme delivered under conventional construction approaches. By ‘pepper-potting’ the physically indistinguishable discounted homes throughout the scheme, there may also be a broader social benefit of creating a mixed and well integrated community within the development.61

It is already possible under existing policy to offer APR instead of affordable housing, and this approach been utilised by some London boroughs. However, the consultation argued that amending the NPPF would make the process easier.

The 2015 Government’s proposed terms for APR were that a minimum 20% of the homes be provided at a minimum of 20% discount, in perpetuity. The discount would be in comparison to local market rents, rather than the rents set within the rest of the development.

Some commentators queried how affordable APR would actually be for many renters. In his Inside Housing column, Jules Birch argued that there was no mention in the White Paper of any rental product that is affordable in relation to earnings, rather than in relation to local market rent prices.62 Rob Gershon in 24 Housing, also argued that affordability was affected by the 20% discount only covering rent, and not service charges.63

The consultation also proposed an increase in the use of ‘family-friendly’ tenancies of three years or more, to reflect the increasing number of families in the PRS. This would be achieved on a non-statutory basis:

> There are no plans to legislate that particular types of private landlord must offer longer tenancies. However, Build to Rent schemes taking up the proposals on Affordable Private Rent set out in this document should be expected to offer family friendly tenancies (to those tenants who want one, and who are eligible

61 Ibid., p14
62 ‘Has the White Paper fixed it?’, Inside Housing, 7 February 2017
63 ‘Housing White Paper: Not Welcome’, 24 Housing, 13 February 2017
to live in the country for that period under the right to rent) and this can be secured through planning obligations.64

The proposals set out in the consultation are similar to those set out in draft Supplementary Planning Guidance published by the Mayor of London in November 2016 (see section 3.2, London).

The law firm, Pinsent Masons, welcomed the White Paper, and argued that it showed serious commitment to new PRS developments:

The government is giving serious thought to build to rent, which may finally see it established in the UK as a mainstream housing product.65

Savills also welcomed the proposals on build-to-rent, noting that they were similar to those in their 2017 report to the British Property Foundation. The Savills report argued that pro-active planning for build-to-rent could accelerate housing supply by as much as three-fold.66

64 Ibid., p17  
3. Institutional Investment – progress & issues

The 2010 Government’s vision of a new private rented sector characterised by a growing number of large-scale, institutionally backed developments emerged from a position of weakness compared to a number of other European countries. The graph above shows over 47% of the Netherlands’ institutional real estate investment in 2011 was held in the residential market compared to less than 1% in the UK.

This comparative lack of institutional investment was highlighted in 2004 in the Barker review of housing supply, which proposed US-style Real Estate Investment Trusts (REITs). These were introduced by the previous Government in 2007, however by April 2011, only one of 23 listed REITs was investing in residential property.

The 2010 Government put a major focus on securing institutional investment to increase the quantity and quality of PRS housing stock and commissioned the Review of barriers to institutional investment in private rented homes (the Montague review), the recommendations and outcomes of which are discussed in sections 2.1-2.4 and 3.2 of this paper.

The British Property Federation (BPF) has published a build to rent map of the UK, plotting the PRS developments completed, under construction or with planning permission, which gives a detailed picture of progress in the development of the build to rent market.

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70 BPF, *Build to Rent Map of the UK*, (last accessed 28 December 2016).
3.1 Economic viability of the private rented sector

There are a number of reasons for the lack of large-scale, institutionally backed developments in England. Of significant importance is the historic demand for owner-occupied properties over PRS homes. In addition, the investment model of the PRS, which is one of long-term financial yields rather than the short-term capital value from sale of owner-occupier properties, creates an investment opportunity that presents greater risks for investors.

As Mark Hafner of the American PRS investor Greystar argued:

The answer is very simple and very obvious; the reason PRS hasn’t flourished in the UK to date is because the for-sale market is so robust here.

For virtually any piece of land you are going to achieve a higher return faster from a for-sale strategy than you are with rental.71

The issue of yields that are susceptible to changes in the market rent rates are significant for institutional investors, particularly with new-build PRS developments, which require a significant investment of capital up front. The Montague review identified this as a concern for potential investors:

We were given a range of figures for yields that would be acceptable to investors. Much of the information given to us was commercially confidential. But there seemed to be a reasonable consensus that the base historic net yield of 3.5% p.a. would be too low to prompt much investor appetite, without the boost to total returns from capital appreciation (which implies sale to owner occupation within a reasonable period after acquisition).72

The review noted that, given the novelty of the large-scale PRS market, yields would have to be particularly high to tempt investors into being the “first movers” in the sector, as well as highlighting necessary changes to increase yields:

A change of paradigm to a long-term residential investment market dependent only on income returns is therefore likely to require higher rents, or lower land, construction and management costs, or some combination of all of these.73

The 2010 Government’s initiatives were aimed at removing the concerns of first movers by providing financial support, as well as a taskforce to promote best practice and therefore lower construction and management costs.74

Whilst there has been demonstrable interest in the Build to Rent fund (section 2.1), the improving owner-occupier market, in part as a result of Help to Buy, has attracted some risk averse investors away from PRS,

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71 ‘Overseas investors target London PRS as UK groups focus on market sale’, Social Housing, 12 September 2014.
72 DCLG, Review of the barriers to institutional investment in private rented homes, August 2012, para 33.
73 Ibid.
74 The prospectus for round two of the Build to Rent fund spelled out this aim: “the Government welcomes bids that include innovative design and construction techniques including, but not limited to, off site construction.”
particularly as the market’s recovery is likely to impact on rental yields. A 23% drop in gross yields between 2009 and 2013 has been directly attributed by commentators to a recovery in the housing market.\textsuperscript{75}

A \textbf{2013 report by EC Harris} on the viability of the build-to-rent model calculated that reducing capital delivery costs such as construction or marketing by 5% (when combined with smaller unit sizes), would make some form of PRS viable in 74% of English local authorities. This compares to 53% of local authorities with neither reduced capital delivery costs nor reduced unit sizes.\textsuperscript{76}

The report argues that, unlike owner-occupation, the PRS model is not viable across the country, and that geographical variations do exist.

Source: EC Harris

The EC Harris report identified the highest residual land values in areas with high employment, rental affordability and a high 25-35 year old demographic (Warwick was the only authority found to have all three characteristics). The most attractive areas for profitable PRS developments were therefore identified as major cities, ‘satellite towns’ commutable to centres of employment and some university locations.

In areas without these characteristics, there appears to be little market appetite for new build PRS given the yields involved. Derwentside Homes in County Durham (a local authority EC Harris calculated no build-to-rent viability for in any of its models), received funding from round one of the Build to Rent fund. This was however on a \textit{rent to buy} model, rather than a permanent PRS development, highlighting concerns about yields solely from rental income raised in the Montague review.\textsuperscript{77}

\textbf{London}

The EC Harris report was keen to stress that its calculations were not definitive, and that variations in viability affected by local characteristics

\textsuperscript{75} ‘Rental yields drop as housing market rebounds’, \textit{Inside Housing}, 7 March 2014.
\textsuperscript{76} EC Harris, \textit{Build to rent: pushing the boundaries}, 2013.
\textsuperscript{77} HCA, \textit{Housing Minister unveils North’s first ‘build to rent’ scheme}, November 2014.
often take place within local authority areas. The most viable regions were identified as the South East, and particularly London.

London’s younger, more mobile labour force, and greater availability of technical and professional employment meant that in 2011, 27% of the population lived in private rented accommodation, compared to 18% for the other English regions.\(^\text{78}\) Modelling by Shelter (2012) found that by 2025, private renting in London could grow to as high as 41% of all households, becoming a bigger tenure than owner-occupation.\(^\text{79}\)

Although EC Harris assesses no London borough as having rental affordability, one of the three local authority characteristics deemed important in the report for build-to-rent viability, this is countered by a shortage in supply and a high demand. The research concluded that 31 out of 33 London local authorities can support high-rise PRS developments, without yield improvement measures on unit size or capital delivery costs. 80% of projects submitting bids for round two of the Build to Rent fund were in London.\(^\text{80}\)

In terms of institutional investment, the London market saw the establishment in 2012 of the UK’s first institutionally backed PRS-only developer, Essential Living, a partnership between Essential Land and M3 Capital.\(^\text{81}\)

Although the London PRS build-to-rent market is larger than much of the rest of the country, it is still vulnerable to changes in the market. Rental returns are higher in London but this is often offset by the comparatively higher cost of land. Between 2013 and 2014, land values in central London rose 18.7% and in outer London 13.2%, compared to 3.9% in the West Midlands, the next largest regional rise.\(^\text{82}\)

Grainger, a major developer of PRS stock, told Inside Housing that their approach to PRS, particularly in London, is not to compete in the open land market. Instead the company attempts to negotiate deals with local authorities for public sector land.\(^\text{83}\)

The recovery in the owner-occupation market has also attracted more risk averse London investors away from the PRS, particularly housing associations (see section 5.1), but also some institutional investors. Press reports in July 2014 said that the UK’s tallest PRS tower development, Newington Butts, was under threat as the developer sought to change the tenure mix to predominantly for-sale units.\(^\text{84}\) However, in June 2015, it was announced that Newington Butts, with funding from the Build to Rent fund, would be developing 278 homes for rent.\(^\text{85}\)

\(^\text{78}\) DCLG, Live tables on dwelling stock (including vacant), Table 109, September 2012  
\(^\text{79}\) GLA Housing and Regeneration Committee, Transcript of Item 4: Strategic Housing and Regeneration, July 2012, p2  
\(^\text{80}\) DCLG, Build to Rent to offer greater choice for tenants, March 2014.  
\(^\text{82}\) Knight Frank, Residential Development Land Index, 2014 (Q2).  
\(^\text{83}\) ‘The private rented sector divide’, Inside Housing, 23 October 2014.  
\(^\text{84}\) ‘Blow to Boris as PRS scheme opts for private sales’, Property Week, 11 July 2014.  
\(^\text{85}\) DCLG, 1,000 new homes for private rent in London, June 2015
3.2 Additional initiatives to attract further investment

The 2010 Government’s Housing Stimulus Package, which followed the publication of the Montague review, announced the introduction of a number of the more tangible measures from the review (see sections 2.1-3).

The review made several additional recommendations beyond those announced in the stimulus package. In 2013 two industry reports on the future of the PRS, Savills’ Montague, one year on: unlocking potential in the private rented sector, and BNP Paribas’ Housing the nation, examined these recommendations in more detail:

Section 106 obligations

The Montague review raised concerns that the specific characteristics of the PRS investment model were not being taken into consideration when setting section 106 (s106) and Community Infrastructure Levy (CIL) planning obligations charges (charges for infrastructure associated with development86):

In principle, the planning system does not distinguish between private rental and owner occupation. But, in practice, people told us that it was generally assumed that homes which were not specifically set aside for affordable housing would be sold to owner-occupiers, or perhaps to small buy to let investors. This assumption is built into calculations of the value of land, including when assessing planning gain for the purposes of determining section 106 and Community Infrastructure Levy agreements.87

BNP Paribas agreed with this point, arguing that “PRS should become a User Class in its own right in planning terms and that local policy should be amended to require ‘a mix of uses’ to include PRS.”88

The 2014 Lyons Review, commissioned by the Labour Party, highlighted the example of Wandsworth Council, which had used s106 conditions to require the delivery of 114 PRS units on a 510 home development. The review recommended extending the scope of local plans in the NPPF to explicitly include an assessment of local need for market rented housing.89

Montague expanded on his argument regarding s106 and CIL charges to focus specifically on affordable housing requirements. He argued that land values based on rental tenure “will often not be strong enough to support the imposition of excessive affordable housing obligations”.90

In September 2013, Savills raised this issue again:

In order to increase supply of privately rented homes further, Local Planning Authorities must be open to negotiations regarding

86 More information on s106 and CIL obligations can be found in the 2014 House of Commons Library Briefing Paper Community Infrastructure Levy.
87 DCLG, Barriers to institutional investment, para 35.
88 BNP Paribas Real Estate, Housing the nation, Summer 2013, p10.
89 The Lyons Housing Review, Mobilising across the nation to build the homes our children need, October 2014.
90 DCLG, Review of the barriers to institutional investment in private rented homes, August 2012, para 49.
affordable housing provision. Although flexibility surrounding Section 106 requirements was a key recommendation by Montague, there is little evidence that this is happening in any meaningful way.\textsuperscript{91}

Although Savills argued that this was not happening, in October 2012, shortly after the publication of the Montague review, the Government introduced its \textit{Growth and Infrastructure Bill}. Clause 5 included a requirement to reconsider affordable housing requirements where they rendered a development unviable.\textsuperscript{92}

This requirement became section 7 of the \textit{Growth and Infrastructure Act 2013}. The \textit{Government’s guidance} on this change required PRS developments to be considered on their own terms:

- For market sales and private rented housing, viability appraisals should be supported by scheme specific evidence from comparable development schemes, taking into regard type of property, location and delivery.\textsuperscript{93}

BNP Paribas welcomed Government changes to the planning system, but raised concerns over the effectiveness of their implementation:

- Whilst Planning Officers follow policy, including the NPPF, and make recommendations for approval; Planning Committees are often too political and ignore these recommendations resulting in too many schemes having to be appealed and go to Inquiry.\textsuperscript{94}

The report instead proposed removing planning decisions from locally elected members, replacing them with permanently employed local officials.

\textbf{Regulatory stability}

According to Montague, one of the major attractions for investors of the UK PRS market is the stability of the regulatory framework for the sector over the past 20 years, which has given investors confidence in stable returns. Montague recommended not only regulatory stability, but for the Government to explicitly commit to this stability to reassure investors:

- Equally, they (investors) warned of the dangers to the attractiveness of the sector were that stability to be undermined. In the 1970s rent controls and restrictions on regaining vacant possession caused institutional interest in the sector to evaporate, and strong Government endorsement of the current status quo in these areas would help to bolster the market.\textsuperscript{95}

Harry Downes of Fizzy Living, a PRS operator, told BNP Paribas that the professionalism of the large-scale build-to-rent sector means there is little tenant demand for legislation on longer-term tenancies:

- FizzyLiving offers tenants flexible lease terms, but not one tenant has taken us up on this offer. They are confident that we will not kick them out, and they prefer to retain the flexibility of being

\textsuperscript{91} Savills, \textit{Montague, one year on: unlocking potential in the private rented sector}, autumn 2013, p10.

\textsuperscript{92} \textit{Growth and Infrastructure Bill}, 2012-13, clause 5.

\textsuperscript{93} DCLG, \textit{Section 106 affordable housing requirements, review and appeal}, April 2013.

\textsuperscript{94} BNP Paribas Real Estate, \textit{Housing the nation}, Summer 2013, p11.

\textsuperscript{95} DCLG, \textit{Review of the barriers to institutional investment in private rented homes}, August 2012, para 26.
able to move out when it suits them. So they stick with a standard 12 months Assured Shorthold Tenancy (ASTs) with a six month break clause.96

Andrew Cunningham of Grainger argued that, as well as there being little demand from tenants, legislation would affect asset value for investors:

Government intervention in tenancy structures is not required. Longer tenancies are often not offered because of a lack of demand among tenants or because of the negative impact that a longer tenancy would likely have on an asset which is valued based on its vacant possession value. As PRS expands, and assets begin to be valued on their net operating income rather than vacancy, longer term tenancies will naturally be made more available by landlords. Legislation is not required.97

In contrast, a 2010 DCLG report argued that investors in other countries may actually be attracted by more secure, longer-term tenancies:

In Germany, Switzerland and the Netherlands institutional investors are not put off by the strong security of tenure that tenants have. In fact long term tenancies are attractive in keeping down voids and management costs and maintaining a secure long term return.98

When the Labour Party announced a manifesto commitment in 2014 to legislate to make three year tenancies the standard for the private sector,99 this attracted both criticism and support from different PRS investors.100

The 2015 Government appeared to support Grainger’s approach, encouraging family-friendly tenancies rather than legislating for them. For example with family friendly tenancies, these can be requested based on a model tenancy agreement developed with the sector. The then Secretary of State for Communities and Local Government, Eric Pickles, stated in 2014 that this approach would avoid “strangling the sector with unnecessary rules and red tape.”101 Applicants for round two of the Build to Rent fund were also encouraged to offer longer-term tenancies.102

Rent controls are also opposed by the sector, with rental income as the predominant source of yields for investors. In its evidence to the CLG Committee, the Young Group, a PRS consultancy, stated that:

It is our view that rent controls would have a detrimental impact on the PRS; reducing both the quality and quantity of accommodation available to residents. It is widely acknowledged that there is a cavernous gap between housing demand and supply. Rent controls/caps will do nothing to alleviate this

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96 BNP Paribas Real Estate, Housing the nation, Summer 2013, p9.
97 Ibid.
98 CLG, Promoting investment in private rented housing supply: international policy comparisons, November 2010.
99 Ed Miliband’s speech on Generation Rent: full text’, New Statesman, 1 May 2014.
100 ‘Investors back Miliband’s PRS reforms’, Inside Housing, 8 May 2014.
101 DCLG, Better tenancies for families in rental homes, October 2013.
102 DCLG, A brighter future for hardworking tenants, October 2013.
imbalance and would act against efforts to encourage investment into the sector to boost supply.  

A response from David Cameron during Prime Minister’s Questions in July 2014 highlighted the Government’s strong opposition to any form of rent controls:

Jeremy Corbyn: …Will he give me an assurance that, in addition to any regulation of the agencies, serious consideration will be given to the need to bring back rent control to protect people and ensure they have somewhere secure and decent to live?

The Prime Minister: …Where I part company with him is on the idea of introducing full-on rent controls. Every time they have been tried, wherever they have been tried in the world, they have failed. That is not just my view; it is also the view of Labour’s own shadow housing Minister, who is on the record as saying that she does not think rent controls will work in practice. Perhaps he might want to have a word with her before coming to me.

Land availability

The limited availability of suitable sites for PRS developments was identified by Sir Adrian Montague as a major constraint to the development of a volume of stock sufficient to attract institutional investment. He suggested that public sector land could be freed up to address this.

Under its public sector land programme, the 2010 Government claimed to have released land for 103,000 homes between 2011 and 2015, with aims to release land for an additional 150,000 homes by 2020. The programme however has no specific measures for the PRS.

BNP Paribas also highlighted a lack of available sites, and proposed a relaxation of planning regulations on Greenfield sites, particularly those on town boundaries. In response to a PQ in December 2014, the then Housing Minister, Brandon Lewis, confirmed that this approach was not a Government priority:

Mr Jim Cunningham (Coventry South) (Lab): Does the Secretary of State agree with me that greenfield sites can be very highly valued by local residents and are important for protecting natural habitats and heritage? As we look to build the much-needed houses, will he take steps to assist local authorities to make sure that brownfield sites and inner-city spaces are fully exhausted before any greenfield sites are built on?

The Minister of State, Department for Communities and Local Government (Brandon Lewis): I agree with the hon. Gentleman. He is absolutely right that local authorities should be looking to develop brownfield sites first. In fact, we are looking at that with the new starter homes programme that the Prime Minister announced today. We have also put in more money over

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104 PQ 904595, 2 July 2014.
105 DCLG, Review of the barriers to institutional investment in private rented homes, August 2012, para 50.
106 DCLG, Unused public sector land will provide over 100,000 new homes, March 2015
107 BNP Paribas Real Estate, Housing the nation, Summer 2013, p14.
the summer to encourage local authorities to develop those brownfield sites first and to make them more viable. 108

London
In November 2016, the Mayor of London, Sadiq Khan, published draft Supplementary Planning Guidance (SPG), which proposed the introduction of a number of the policy proposals set out above.

The SPG would see the introduction of a ‘Build to Rent pathway’ through the planning system, requiring a standardised definition, which would include:

- Homes to be held as build-to-rent under a covenant for at least 15 years.
- All units self-contained and let separately.
- Unified ownership and management of the developments.
- Longer tenancies offered (three years or more) with defined in-tenancy rent reviews.

It also stated that build-to-rent developments would be able to meet their affordable housing requirements solely through discounted market rent (rather than also including a mix of social rent and intermediate housing/shared ownership, as in other development types).

For plans with less than 35% of affordable housing (not provided by grant funding), developments would have to go through a viability process, and the SPG sets out specific considerations for the viability of build-to-rent (including a different approach to profit compared to build for sale).

In addition, the SPG set out more general help that could be offered to build-to-rent schemes, including supporting institutional investment on public land, and looking at the role REITs could play in attracting investment. 109

Reactions from the sector have so far been positive, although some, such as Harry Downes of Fizzy Living, argued that the changes should be enshrined in law rather than planning guidance to prevent local councillors ignoring guidance for political reasons. 110

3.3 Budget 2016
The 2010 Government implemented a number of policy initiatives to increase institutional investment in the PRS (see section 2), however measures introduced in the first Budget of the 2015 Government suggested that this emphasis on institutional investment may be changing.

The 2015 Autumn Statement announced a three percentage point Stamp Duty Land Tax (SDLT) surcharge on additional residential properties over £40,000, including buy-to-let properties, from April

108 PQ 906611 [House building], 15 December 2014.
109 Mayor of London, Homes for Londoners: Draft Affordable Housing and viability supplementary planning guidance 2016, November 2016
110 ‘Build-to-rent experts welcome Khan planning guidance’, Inside Housing, 30 November 2016
2016. The Government also announced that it would consult on whether to introduce an exemption for corporates and funds owning more than 15 residential properties.\(^{111}\)

The consultation outcome was announced during the 2016 Budget, which confirmed that the exemption would not extend to large-scale investors. Given the start date for the policy announced in the 2015 Autumn Statement, this meant that large-scale investors had around two weeks’ notice that the SDLT surcharge would also apply to them.

In the summary of consultation responses, the Government justified this change by stating that:

On balance, following an assessment of the evidence provided in response to the consultation, the government’s view is that the evidence suggesting that in the absence of an exemption there would be an adverse and material effect on housing supply is not compelling. Whilst the higher rates may have some effect on off-plan purchases, the government’s view is that the overall effect on housing supply is not material and housing developments will remain attractive for corporate investors as well as potential home owners.

The government has had regard to the significant support it is offering to the housing market more generally, for example through government-led schemes which are designed to support an increase in housing supply. The Private Rented Sector guarantee scheme offers significant support for investors in the rental market. The government also notes the existing flexibilities within the SDLT system available to significant investors in the property market.\(^{112}\)

Also announced was an increase of SDLT on commercial property for transactions above £1.05 million. Although this does not apply to commercial property sales, Inside Housing noted that this would affect large-scale investors buying sites to develop homes for market rent.

In an article exploring the impact these changes would have on institutional investment in the PRS, Inside Housing found disappointment from the sector, but not a belief that this would significantly affect the market:

Jason Hardman, head of residential valuations at property advisors CBRE, says sellers are accepting lower offers from investors as a result. “From a valuation perspective, the surcharge has been effectively knocked off the total [price paid] figure,” he says.

He adds, though, that backers can mitigate the tax hike by structuring the deal as a “forward funding transaction, whereby the purchaser buys the land, typically at the start of construction, then funds the development costs in a series of payments during building of the scheme, before taking possession of the completed property. This means that stamp duty land tax is paid on the land and not on the value of the completed development, hence there is a saving”. As for the bigger picture? “We’re not

Building the new private rented sector

seeing a slowdown in [investment] activity," Mr Hardman reports.113

The Government’s summary of consultation responses also alluded to these flexibilities for large-scale investors.

The 2016 Budget also saw changes to Capital Gains Tax, which arguably more explicitly set out a change in policy emphasis away from institutional investment in the PRS (emphasis added):

The government wants to ensure that companies have the opportunity to access the capital they need to grow and create jobs, and wants the next generation to be backed by a strong investment culture. Budget 2016 announces that, from 6 April 2016, the higher rate of Capital Gains Tax (CGT) will be reduced from 28% to 20%, and the basic rate will be reduced from 18% to 10%. There will be an 8 percentage point surcharge on these new rates for carried interest and for gains on residential property. This will ensure that CGT provides an incentive to invest in companies over property.114

113 ‘Has build-to-let got a future?’, Inside Housing, 30 June 2016
114 HM Treasury, Budget 2016, March 2016, para 1.171
4. Individual landlords

Despite recent efforts to increase institutional investment and large-scale PRS developments, the sector remains dominated by small-scale landlords. As previously stated, the PRS is frequently described as a cottage industry.

The CLG Committee’s 2013 report questioned whether the Build to Rent fund was focused on the development of new housing for the middle classes. The Committee recommended that the Government should boost supply across the sector as a whole, if it could not be demonstrated that this was already happening.115

The economic profile of the PRS is not dissimilar to the population as a whole, according to a 2013 Building and Social Housing Foundation (BSHF) study, Who lives in the private rented sector?, with a slight over-representation of the lower income groups.116 The build-to-rent model, with market rents, may not be suitable for a large proportion of the PRS market, particularly low-income households affected by Housing Benefit restrictions since 2010.

Shelter’s response to the Montague review criticised it for focusing solely on institutional investment at the expense of the rest of the PRS:

> It (the review) misses a trick in offering nothing for the millions of people already in the sector, paying sky-high rents and living under constant threat of eviction or further rent rises. No solutions for our rental market could be complete without measures to address this lack of stability.117

As well as new, large-scale, institutionally backed developments, the other aspect of the 2010 Government’s private rented sector policy was “an abundance of good, small scale private landlords.”118 89% of landlords in England are private individuals and 98% of private landlords own fewer than 10 properties and 70% of all dwellings.119

With the significant majority of the existing PRS stock owned by individual investors, developing a ‘new private rented sector’ involves changes to individual landlord practice as well as the promotion of large-scale, professionally managed build-to-rent developments.

4.1 The buy-to-let market

Much of the recent growth in the PRS has been from individual landlords, and a major driver of this has been the availability of buy-to-let mortgages. A study by the Intermediary Mortgage Lenders Association (IMLA) found that since the introduction of buy-to-let

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117  Shelter, Shelter responds to Montague Report, August 2012.
Building the new private rented sector mortgages in 1996 they have financed 1.4 million of the additional 2.6 million homes in the PRS.  

Critics of buy-to-let argue that the growth in the PRS is at the expense of homes for owner-occupation. IMLA figures show that in contrast to the rapid growth of PRS, the stock of owner-occupied homes between 2000 and 2012 grew by only 400,000 and has been shrinking since 2007. Alex Hilton of Generation Rent has criticised the perceived lack of a level playing field between owner-occupiers and buy-to-let investors, who can qualify for interest-only deals and can offset mortgage interest against tax.

The 2015 Budget saw an announcement that some of these advantages for buy-to-let investors would be reduced:

This Budget… restricts relief for mortgage interest for individual landlords to the basic rate of income tax, phased in over 4 years, limiting the advantage that these individuals currently enjoy over those purchasing their own home.  

This was followed by an announcement in the 2015 Autumn Statement of a three percentage point Stamp Duty Land Tax (SDLT) surcharge for additional properties such as buy-to-lets from April 2016, as a measure “to support families buying their own home.” Whilst the announcement raised concerns that it could mean the “final nail in the coffin” of buy-to-let, HMRC statistics for the third quarter of 2016 show 24% of sales (of properties under £40,000) going to buy-to-let investors (or as additional homes).

Whilst critics of buy-to-let have highlighted perceived advantages for investors over owner-occupiers, others, such as IMLA, have highlighted comparative disadvantages for investors, such as buy-to-let sales being subject to Capital Gains Tax (CGT). The Institute for Fiscal Studies looked at the impact of recent changes on landlords, and highlighted tax disadvantages compared to owner-occupiers:

- A reduction in the tax relief available for landlords’ mortgage interest, due to be phased in over four years from April 2017, will significantly reduce the attractiveness of buy-to-let housing as an investment among higher-rate taxpayers who require mortgage finance. For a ten-year buy-to-let investment 50% financed by a mortgage, the effective tax rate for a higher rate taxpayer will increase from 47% to 76%.

- Alongside changes to inheritance tax and stamp duty land tax, this will increase the existing tax advantage of owner-occupiers.

121 Ibid., p5.
122 ‘Britain becomes a nation of renters as buy-to-let prices out new buyers’, *The Times*, 1 January 2015
123 HM Treasury, *Summer Budget 2015*, July 2015, p3
125 ‘Buy-to-let stamp duty rise ‘final nail in coffin’ for small landlords’, *The Telegraph*, 25 November 2015
126 HM Revenue & Customs, *Quarterly Stamp Duty Statistics*, September 2016, Table 4
occupation, which arises because landlords are taxed on their rental income and capital gains whereas owner-occupiers do not pay tax on their ‘implicit rental income’ (the in-kind reward enjoyed by owner-occupiers as a return to their investment: the notional rent they pay themselves as simultaneously tenant and landlord) and main homes are exempt from CGT.

- It also strengthens the incentive to invest in a property via a company rather than directly, though there are other obstacles to that.  

4.2 Initiatives to attract further individual investment

Land supply
The Residential Landlords’ Association (RLA) 2017 ‘election manifesto’ set out a number of policy initiatives it argued would boost the supply of PRS dwellings by encouraging individual investment, focusing largely on land supply and taxation reform.

With regards to land supply, the RLA called for the Government to free up “small plots of unused land, unattractive to corporate investors, for use for private rented sector housing.”  

This built upon calls in the RLA’s 2015 manifesto for the Government to extend the reach of its public sector land programme from just large plots, to include smaller plots that can be quickly developed by individual landlords.

As mentioned previously, the public sector land programme does not specifically focus on the PRS, nor as the RLA mentioned, on smaller plots. With regard to smaller developments however, the Government has implemented measures to encourage their development.

Following a consultation in March 2014, the Coalition Government announced in its November 2014 response, Planning contributions (section 106 planning obligations), that it would introduce a 10-unit minimum threshold for s106 affordable housing requirements on any new housing development (with an option for a lower, five-unit threshold in designated rural areas).

In July 2015, the High Court ruled that the 10-unit minimum threshold was unlawful. The Government appealed this judgement in the Court of Appeal and on 11 May 2016 the High Court’s ruling was overturned.

These changes are now reflected in the National Planning Practice Guidance’s pages on planning obligations.

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128 Institute for Fiscal Studies, The Effects of Taxes and Charges on Saving Incentives in the UK, February 2016, p5
129 RLA, A Manifesto for the Private Rented Sector, April 2017, para 2.8
131 DCLG, Planning contributions (Section 106 planning obligations): Government response to consultation, November 2014.
132 DCLG, Judgement paves way to build more homes on small sites, May 2016
Taxation reform

In its pre-Autumn Statement 2016 briefing, the RLA called for taxation reform in a number of areas to reduce the perceived disadvantages for buy-to-let in comparison to owner-occupation. This included reversing the three percentage point increase on SDLT (see section 4.1) and extending the Value Added Tax (VAT) relief on goods and services related to the construction of a new dwelling, which is not currently permitted on new build dwellings intended for rent.\(^{133}\) The RLA’s 2017 ‘election manifesto’ again called for the reversal of the SDLT changes, as well as the reversal of mortgage interest relief changes announced in 2015 (see section 4.1).\(^{134}\)

Another perceived disadvantage relates to CGT, for which buy-to-let sales are liable, whilst a number of owner-occupier sales qualify for Private Residence Relief. The RLA has previously argued for the introduction of CGT relief when sale proceeds are reinvested, and when properties are sold to first time buyers.\(^{135}\) The German PRS operates a similar system of re-investment relief to that proposed by the RLA.\(^{136}\)

Press reports indicate that HM Revenue and Customs (HMRC) have stepped up enforcement of CGT avoidance by buy-to-let property owners, leading to a 24% increase in 2013/14 collections compared to the previous year.\(^{137}\)

A further concern of the RLA is the lack of relief in the tax system for re-investment in and improvement of property standards. The LSE study *Towards a sustainable private rented sector* notes that a similar ‘depreciation allowance’ exists in a number of European countries including Germany, the Netherlands, Ireland and Finland (although in Finland this is only for institutional landlords).\(^{138}\)

The Coalition and 2015 Governments did not indicate any intention to implement these proposals. In the *2014 Autumn Statement* the Coalition Government did announce changes to simplify SDLT:

> To reduce distortions and improve the fairness of the tax system, Autumn Statement announces that the government will reform SDLT on residential property with immediate effect. From 4 December 2014, SDLT rates will only apply to the part of the property price that falls within each band, similar to the structure of Income Tax. The effective rate of SDLT will rise steadily as property values increase, removing the distortions created by the existing system, where the amount of tax due jumps at the thresholds. Transitional rules will allow buyers who have already exchanged on a home but not completed before 4 December 2014 to choose whether to pay SDLT under the existing or new rules.

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134 RLA, *A Manifesto for the Private Rented Sector*, April 2017, para 2.8
135 RLA, *Election Manifesto 2015*, January 2015, p26
137 *HMRC investigations into buy-to-let spark surge in tax receipts*, The Telegraph, 10 January 2015.
As part of the reform, the government is introducing new rates and thresholds for SDLT on residential property to ensure this change is introduced in a fair way. As a result, SDLT will be cut for 98% of people who pay it.139

These changes were welcomed by the National Landlords Association (NLA), which had campaigned for SDLT reform:

We are delighted that the Chancellor has listened to the NLA and recognised the inequity of the SDLT ‘slab’ system...

The introduction of a straightforward marginal system of taxation will mean private landlords will now not only face lower costs when acquiring property, but also have funds to implement property improvements and keep rents down.140

**Houses in multiple occupation**

The RLA’s 2015 ‘election manifesto’ also called for reform of planning regulations to get rid of ‘Article 4 Directions’ with regards to Houses in Multiple Occupation (HMOs).141 Since October 2010 local authorities have been able to use their direction-making powers to restrict changes of use (from family homes to HMOs) by requiring planning applications where they deem it necessary.142

The RLA say the number of councils making these directions is growing, and that this is restricting the growth of HMOs, which it argues are required to address the housing need of groups such as young professionals.143 The NLA is also opposed to the use of Article 4 Directions and agrees that they are restricting the provision of a much-needed PRS type.144

This proposal was not included in the RLA’s 2017 ‘election manifesto’. In its response to the CLG Committee report on the PRS the Coalition Government indicated it would not be looking to change the regulations:

**Recommendation 16**

Where there are community concerns about high concentrations of houses in multiple occupation, councils should have the ability to control the spread of HMOs. Such issues should be a matter for local determination. We therefore consider it appropriate that councils continue to have the option to use Article 4 directions to remove permitted development rights allowing change of use to HMO.

The Government agrees with the Committee’s recommendation. Councils will continue to have the option to use Article 4 directions where there are concerns from the local community about high concentrations of houses of multiple occupation.145

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5. Social landlords’ PRS initiatives

5.1 Housing associations

The 2010 Spending Review set out the Government’s intention to continue with capital investment in social housing, but on a much more modest scale than before. The review also brought in a new intermediate rent for social tenants, set at 80% of market rents.\textsuperscript{146}

The National Housing Federation’s (NHF) response to the review expressed concern that rental income was now expected to play a much larger part in funding social housing than before:

> We are extremely disappointed that the Government has chosen to impose such significant cuts on the levels of capital funding available. It appears that Government has chosen to move at a rapid pace to a system of personal subsidy to deliver new homes at scale.\textsuperscript{147}

Although housing associations using PRS income to cross-subsidise their social objectives is not a new occurrence (a Joseph Rowntree Foundation (JRF) report from 2003 examined this housing delivery model\textsuperscript{148}), reductions in grant funding for new housing association developments since 2010 have encouraged more to look at cross-subsidisation as an option.

The Montague review noted the potential of housing associations to impact upon the build-to-rent market:

> The potentially important role of housing associations deserves special mention. Among the larger associations, there is starting to be considerable interest in market rent developments as a natural complement to their existing activities in affordable housing. The associations have the potential to become key players in the development of bespoke private rented schemes, as the balance sheets of at least the strongest among them will support standalone capital raising to finance developments. In addition, their existing affordable housing portfolios give them both asset management expertise and a strong platform to offer a professional service to tenants.\textsuperscript{149}

A 2012 Resolution Foundation report also noted that the scope of larger associations may mean they can avoid some of the difficulties of attracting investment due to a lack of sites for large scale-developments:

> Units could be built by the consortium (of housing associations) on sites across the country to generate the scale of investment required by investors without that having to be delivered on a single site. For example, 10 sites that could accommodate 100

\textsuperscript{146} HM Treasury, \textit{Spending Review 2010}, Cm 7942, October 2010.
\textsuperscript{147} NHF, \textit{Comprehensive Spending Review – Briefing for National Housing Federation Members}, October 2010.
\textsuperscript{148} JRF, \textit{Developing and managing market renting schemes by housing associations}, February 2003.
\textsuperscript{149} DCLG, \textit{Review of the barriers to institutional investment in private rented homes}, August 2012, para 28.
units each could create a fund of £100 million to attract large scale investors.\textsuperscript{150}

In January 2014, the then Housing Minister, Kris Hopkins, confirmed that 13 out of 95 total bidders for round one of the Build to Rent fund, and six out of 125 bidders for round two, self-identified as social landlords.\textsuperscript{151}

Inside Housing also reported that many large housing associations, including Notting Hill and Genesis are known to have considered applying to the PRS housing guarantee scheme.\textsuperscript{152}

As well as directly bidding for funding and finance guarantees, some housing associations are creating subsidiary companies to act as their commercial arm in the PRS, with profits reinvested in social housing objectives. In 2014, one of the largest such commercial organisations, Fizzy Living, a subsidiary of Thames Valley Housing Association (TVHA), secured £200 million of institutional investment from Silver Arrow, an entity owned by the Abu Dhabi Investment Authority.\textsuperscript{153}

Housing associations entering the PRS are subject to the same concerns over yields and sustainability as institutional investors. Notting Hill Housing Group reportedly scaled back its PRS target after deciding that putting properties up for sale would generate more money for cross-subsidisation.\textsuperscript{154} Keith Exford, Chief Executive of Affinity Sutton raised similar concerns:

\begin{quote}
We remain unconvinced that [PRS] is a worthwhile activity for us,\textquoteright; he says. \textquoteleft We don\textquotesingle t believe that private renting is a charitable activity. Therefore, it is a commercial one, and we don\textquotesingle t view the returns on PRS as sufficient. Why would we want to take the profit slowly? The only reason we want the profit is to build more affordable homes.\textsuperscript{155}
\end{quote}

Where housing associations are operating successfully in the PRS it is often where they are not doing so solely for the purpose of cross-subsidising affordable housing, but because they believe the provision of PRS is in itself beneficial. Elizabeth Froude of Genesis told Inside Housing:

\begin{quote}
We always say we are here – particularly in London – to provide housing for people in the squeezed middle as much as people at the bottom end. It\textquotesingle s not a great big commercial activity for us, but we build enough to create some return in cross subsidy.\textsuperscript{156}
\end{quote}

\begin{footnotes}
\item[150] Resolution Foundation, \textit{Making institutional investment in the private rented sector work}, July 2012.
\item[151] PQ 177357 [Private rented housing: construction], 26 November 2013.
\item[152] \textquoteleft PRS Housing Guarantee Scheme prepares to issue £265m bond\textquoteright, \textit{Inside Housing}, 11 November 2016.
\item[153] TVHA, \textit{Fizzy Living raises new capital commitment of £200m}, March 2014.
\item[154] \textquoteleft Overseas investors target London PRS as UK groups focus on market sale\textquoteright, \textit{Social Housing}, 12 September 2014.
\item[155] \textquoteleft The private rented sector divide\textquoteright, \textit{Inside Housing}, 23 October 2014.
\item[156] Ibid.
\end{footnotes}
Similarly Clarendon Living, a subsidiary of Watford Community Housing Trust, emphasises the benefit its ‘ethical’ approach as a landlord can have for tenants, as well as the benefits of cross-subsidisation.157

2016 research by Tony Crook and Peter Kemp found that housing associations in England own around 40,000 PRS units, but that this was largely the result of a few large portfolios by a small number of associations (36% of the 40,000 were owned by 11 housing associations). They also noted that housing associations have been responsible for building 24% of the 27,000 PRS units completed since 2010.158

As an example of the PRS ambition of some of the larger housing associations, in 2016 L&Q announced plans to build 5,000 new PRS homes over the next five years, which it claims would see it build the UK’s largest portfolio of purpose-built PRS homes.159

5.2 Local authorities

Some local authorities have also begun to develop a greater involvement in the PRS. Unlike housing associations however, their role has largely been to facilitate an increase in PRS stock, rather than developing market rental properties themselves to cross-subsidise social housing objectives.

A 2013 report by the London Assembly recommended that councils could be “introducing flexibilities over social rented stock use (for example by renting out under-utilised properties at market rents) providing the resultant income is reinvested back into council homes.”160

There does not appear to be any evidence that this is happening on any significant scale (although Manchester City Council and the Greater London Authority both made it onto the shortlist of bidders for round two of the Build to Rent fund). As the report itself notes, in the last 10 years, councils have built less than 0.5% of new homes in England, therefore any moves by local authorities in this direction would likely have little impact on the overall PRS.

The market is beginning to anticipate greater local authority involvement. In June 2015, a £200 million per year investment fund was launched by Legal & General for local authorities to help them counter one of the main problems in developing build-to-rent housing stock, sourcing adequate funding.161

Whilst their direct provision of PRS stock may currently be limited, local authorities are developing different approaches. A 2014 Local Government Association (LGA) report gives the example of Ashford,

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158 ‘Housing associations own 40,000 PRS units’, Inside Housing, 18 May 2016
159 ‘L&Q opens first scheme in 5,000-home PRS plan’, Inside Housing, 26 January 2016
161 ‘One-stop shop’ to build PRS homes’, Inside Housing, 19 June 2015.
which has set up a council owned housing company to deliver new PRS stock.\textsuperscript{162}

Inside Housing reports that the “power of competence” introduced by the \textit{Localism Act 2011} has encouraged a number of authorities to set up housing companies, with Newham and Ealing cited as examples of companies providing some new PRS stock within mixed tenure developments.\textsuperscript{163}

As well as arms-length development, some local authorities have also been utilising institutional investment, such as Local Government pension funds. The high rent levels in Leeds prompted the West Yorkshire Pension Fund to begin discussion with Leeds City Council over release of land for new developments.\textsuperscript{164}

In 2014, Manchester City Council (MCC) entered into a formal partnership with Greater Manchester Pension Fund (GMPF) to provide new developments on council land, including new PRS units. Although GMPF will receive priority returns, the council will receive secondary returns to recover its land value costs.\textsuperscript{165}

The LGA report cites a number of other approaches by councils to deliver new PRS stock, including Eastleigh’s guaranteed purchase model and Kent’s land release deal with the Kier Group.\textsuperscript{166}

The release of public sector land to PRS developers also allows local authorities to attach conditions for higher standards of property management, such as the required implementation of the London Rental Standard at the Pontoon Dock development on released Greater London Authority land.\textsuperscript{167}

\textsuperscript{162} LGA, \textit{Supporting housing investment: a case study guide}, February 2014.
\textsuperscript{163} ‘Breaking free to build homes’, Inside Housing, 11 April 2014.
\textsuperscript{164} ‘Councils consider PRS land handover plan’, Inside Housing, 7 September 2012.
\textsuperscript{165} HCA, \textit{Manchester’s innovative Housing Investment Fund given green light}, April 2014.
\textsuperscript{166} LGA, \textit{Supporting housing investment: a case study guide}, February 2014.
\textsuperscript{167} Greater London Authority (Housing Investment Group), \textit{‘Agenda item: Pontoon Dock (part reserved)’}, 10 September 2014.
6. Prospects for future growth

The Coalition Government’s response to the CLG Committee report in October 2013 reiterated an investor-friendly approach for future policy, without the need for what it felt would be excessive regulation:

The Government does not support a wide-ranging review to consolidate legislation covering the private rented sector at this time. We are firmly of the view that a wide ranging review would introduce uncertainty into the sector and would slow down investment at a time when it is most needed. It would also provide significant and unwarranted upheaval for tenants and landlords.

However, the Government does recognise that both tenants and landlords would benefit from more information and an improved understanding of the flexibilities which exist within the existing legal framework.168

The 2015 Government continued with this approach towards regulation of the sector.

Some recent policy changes, such as the changes to SDLT, may suggest a change in Government emphasis away from an institutionally backed PRS. However, it is also arguable that these changes are consistent with the original policy intention to kick-start the market without providing an enduring subsidy.

Following Theresa May’s first Conservative Party Conference speech as Prime Minister, it was reported that she was signalling a change in focus away from homeownership products towards measures to boost overall supply.169 Whilst this could theoretically provide more build-to-rent opportunities, the decision to incorporate the Build to Rent fund into the Home Building Fund did not suggest any prioritisation of increased supply in the PRS.

It should be noted however, that the first loan from the Home Building Fund, of £45 million, was made for the provision of 2,000 PRS homes in Leeds, Birmingham and Manchester. In announcing the deal, the then Housing Minister, Gavin Barwell, argued that the Government was still actively promoting the private rented sector:

Alongside homeownership, we’re determined to create a bigger, better private rental market to offer greater choice for tenants in a country that works for everyone.

This is one of the largest private rental sector deals in the UK and will not only create thousands of homes for people in Birmingham, Leeds and Manchester – it will create jobs and opportunities for many hundreds of people170

The publication of the Housing White Paper in February 2017 arguably indicated some reprioritisation towards the build-to-rent market.

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169 ‘May focuses on supply in policy shift’, Inside Housing, 5 October 2016
170 ‘Government injects £45m into 2,000 private rental homes’, Inside Housing, 1 December 2016
Proposed changes to the NPPF (see section 2.4) were intended to encourage planning authorities to take greater consideration of build-to-rent as a model to meet local housing needs, and to improve the financial viability of developments by increasing the use of affordable private rented homes to meet planning obligations.

The consultation on build-to-rent, which was launched alongside the White Paper and closed on 2 May 2017, argued that the policies indicated “a clear signal of Government support for Build to Rent as an enduring feature of the housing market,” as well as indicating the potential of the model to substantially increase housing supply:

Industry sources have referred to the potential, with the right level of government support, for supply of Build to Rent homes to reach 10,000 homes per year by 2020 and for the level of investment appetite to grow beyond the £50 billion that has been posited by Knight Frank and others. The growth of the industry in the USA over the past three decades gives an indication of the potential.171

Knight Frank’s *Multihousing* research, published in June 2017, estimated an even larger increase in total build-to-rent investment. Its estimates see investment reaching £70 billion by 2022, up from the £50 billion by 2021 from previous research, which was cited in the White Paper.172

In terms of wider market conditions, concerns were raised following the EU referendum that market uncertainty could affect the PRS market. As Allsop noted:

> It is logical that some will be unwilling to enter full forward funding agreements for larger scale, premium product developments for the foreseeable future without any inbuilt financial downside risk protection. 173

However, some investors, such as Alex Greaves of M&G Real Estate argue that institutional PRS investment could even become more attractive post-Brexit:

Residential’s low correlation with commercial property is likely to serve it well. The sector proved its defensive characteristics during the steep market downturns in both the 1990s and 2000s, when residential property not only recorded a smaller capital decline than its commercial counterpart but also recovered its initial value faster. Pension funds and other long-term institutional investors are very much aware of this.

In the short term, of course, there is likely to be volatility in capital values, particularly prime central London - which was already showing signs of slowing down before the referendum. It could be the most affected resi (residential) sector, but some of that pressure could be offset by the competitive exchange rate attracting foreign investment.174

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171 DCLG, *Planning and Affordable Housing for Build to Rent: a consultation paper*, February 2017, p9
173 Allsop, *How does Build to Rent fit into BREXIT?*, September 2016
174 *PRS foundations remain firm in wake of Brexit vote*, *Property Week*, 28 July 2016
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