Buy-to-let at a crossroads

July 2019

Executive summary

- **The private rented sector (PRS) is vital to a well-functioning housing market.** Politics has always played an important role in shaping the evolution of different tenures in the UK, from the council house building boom of the 1950s and 1960s to the Thatcher government's promotion of homeownership in the 1980s. Since the 1990s, both Conservative and Labour governments have recognised the benefits of a vibrant PRS as it can respond flexibly to rising demand and accommodates the needs of a mobile workforce. But now we face a political backlash as both parties seek to woo PRS tenants and frustrated would-be first time buyers.

- **Largely because of adverse tax and regulatory changes since 2015, the two decade expansion of the PRS may be coming to an end.** The PRS has seen enormous growth over the past two decades, taking it from 9% of Great Britain's housing stock in 1999 to 20% by 2016, with the sector adding 3.1 million properties. The latest tenure data, for 2017, show the first annual decline in the number of PRS properties since 1999, which may point to a topping out of the sector.

- **Profile of private landlords is changing.** The tax and regulatory changes seen since 2015 have also impacted the profile of the PRS, having had the greatest impact on smaller scale landlords. The English Private Landlord Survey showed that in 2018 21% of the PRS housing stock was owned by landlords with one property, down from 40% in 2010, while landlords with five or more properties accounted for 48% of the PRS in 2018, up from 38% in 2010. There is also more institutional investment taking place in the PRS. This 'professionalisation' of the PRS should help to drive up standards but smaller scale landlords add diversity to the rented housing stock and government should recognise that the regulatory burden falls more heavily on them.

- **Threat of further adverse policy changes remains.** The Tenant Fees Act 2019 is the latest piece of legislation impacting landlords (as well as letting agents). The government has also announced it is consulting on removing Section 21 of the Housing Act 1988, which would restrict landlords' right of eviction under an Assured Shorthold Tenancy (AST). But landlords fear more draconian legislation, particularly if a Labour government is elected.

- **The future of the PRS will depend, more than anything else, on government policy.** We have created four scenarios for the future evolution of the PRS based on different government policies on the sector. If policies remain broadly unchanged, the PRS in Great Britain could stabilize at c.18% of the housing stock against 19.4% in 2017. But if rent stabilization is introduced and no-fault evictions under Section 21 of the Housing Act 1988 are removed, the PRS could decline to around 16% of the housing stock by 2030 (a fall of 460,000 units). Hard rent controls and indefinite tenancies would have a far more serious detrimental impact on the sector but, conversely, if government reversed some of the adverse tax and regulatory changes introduced since 2015, the PRS could stabilize at around 20% of the housing stock. With the right policies to help first-time buyers and new housing supply, this could support a balanced housing market which worked for tenants but recognized the aspiration of most people to buy.

- **The buy-to-let sector could out-perform the wider PRS.** Only 35% of the 5.4 million properties in the PRS in Great Britain have a buy-to-let mortgage. Some properties have commercial mortgages, particularly where the landlord is a large corporate such as Grainger plc, but there is no industry data to establish the size of commercial lending on residential property. Many properties are known to be unmortgaged. The PRS and buy-to-let sectors do not always move in unison. For example, during the financial crisis buy-to-let lending shrank dramatically but the PRS grew more rapidly. But since 2009, buy-to-let lending for house purchase has recovered while the growth of the PRS has slowed sharply, suggesting that buy-to-let could out-perform the PRS in its future growth, although buy-to-let is now a mature lending segment.

- **IMLA calls for a moratorium on further adverse tax and regulatory changes affecting the PRS.** We are concerned with the amount of additional regulation that has impacted both the PRS and buy-to-let sector since 2015: a series of policy changes have been put in place before the authorities have had time to fully evaluate the effect of any of these changes. So far, the additional burdens on landlords have not led to a mass exodus but even a modest decline in the size of the PRS will reduce tenant choice and could push up rents. We therefore think the authorities should take time to evaluate the impact of existing changes before introducing any further adverse tax or regulatory measures.

1. The changing shape of the PRS

1.1 A quick history of housing tenures

The UK has undergone three main shifts of housing tenure since the Second World War. The most significant was the rise of owner-occupation, which was an established trend as far back as the 1950s. The owner-occupied housing stock in Great Britain went from 4.1 million in 1951 to 12.0 million by 1981 and 17.1 million by 2001. The second was the rise of the social rented sector which went from 2.6 million in 1951 to 6.9 million in 1979. Both grew at the expense of the PRS which shrank from 7.1 million in 1951 (then 52% of the housing stock) to 1.9 million at its low point in 1986.

The third main trend is the resurgence of the PRS since the mid-1980s. It added 3.6 million units between 1986 and 2016 when it reached 5.4 million. Between 1999 and 2016 alone it added 3.1 million units (see Chart 1), accounting for 96% of the growth of the total housing stock over this period. Indeed, between 2002 and 2016, the PRS grew faster than the housing stock as a whole.

Chart 1 – Cumulative change in size of housing tenures since 1999 (Great Britain)

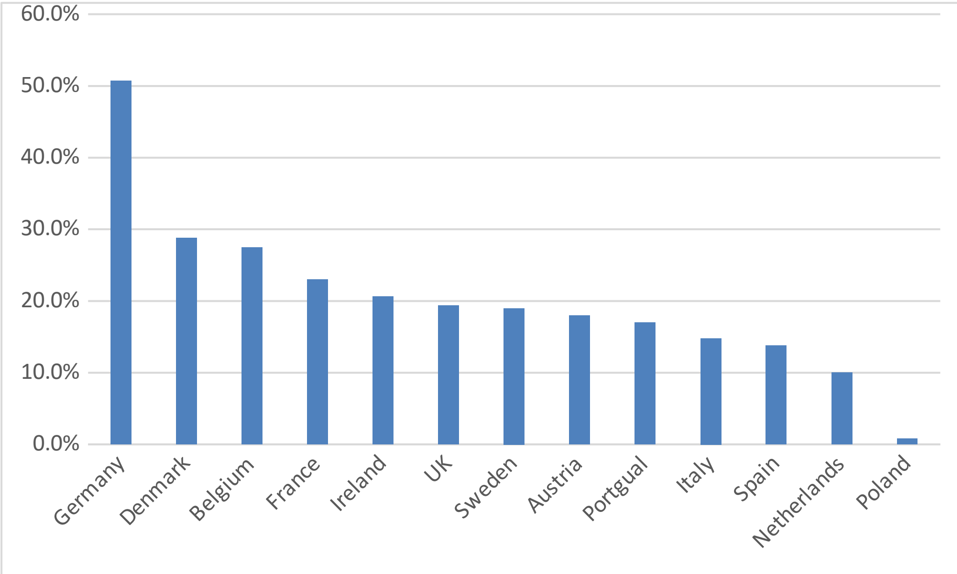
Source: MHCLG

1.2 The PRS at a turning point

Government policy has always played a key role in shifting the balance of housing tenures in the UK. Between the 1950s and 1970s government invested heavily in social housing and from 1979, the Thatcher government sought to boost homeownership through council house sales and mortgage deregulation. Government controls on the PRS also contributed to the steep decline in this sector until the late 1980s when the 1988 Housing Act introduced a more landlord-friendly tenancy framework in the AST.

From the 1990s, government policy did not overtly favour any one tenure but there has been little investment in the social housing sector and mortgage interest relief at source (MIRAS) for owner-occupiers was gradually reduced and finally abolished in 2000. A lack of new social housing and reduced tax breaks for owner-occupation assisted the growth of the PRS but, at less than 10% of the housing stock in the 1990s, the UK PRS was unusually small compared to other European countries. But after its rapid growth this century, the UK PRS now sits in the middle of the range in Europe (see Chart 2), with a PRS that is larger than is typical in eastern and southern Europe but smaller than that of many western European countries, especially Germany, which is an outlier at 51%.

Chart 2 – PRS as a percentage of the housing stock for selective European countries



Source: Housing Europe

While both Conservative and Labour governments were comfortable with an expanding PRS in the 1990s and 2000s, given its ability to respond flexibly to rising housing demand, political concern that the PRS was crowding out homeownership led to a clear change of policy from 2015, when the newly elected Conservative government hiked taxes for landlords, including restricting the mortgage interest tax deduction to the basic rate. Higher taxes have been coupled with tighter regulation of buy-to-let lending and a raft of new regulatory burdens on landlords including the requirement to make right-to-rent checks, the need for energy performance certificates (EPCs) and tighter regulation of houses in multiple occupation (HMOs).

Housing tenure estimates for 2017 showed the first decline in the size of the PRS in Great Britain since 1999. Although it is too early to say that this is the start of a trend toward a smaller PRS, the last few years do seem to represent something of a turning point for the sector.

Lack of political support for the PRS is undoubtedly the primary factor behind the changed trajectory. The Conservative Party enabled the regeneration of the PRS with the AST, and saw a healthy PRS as an important part of a balanced housing market, allowing people the flexibility to move to where jobs were. But as the PRS has expanded and homeownership has declined sharply amongst younger households, the Conservatives have become concerned that the home-owning dream is being undermined by an over-sized PRS. However, we would question the view that a healthy flow of first-time buyers requires a shrunken PRS, as evidenced by the recovery in first-time buyer numbers and buy-to-let house purchase lending since the financial crisis. During the 5-year period 2009-2013 there were 1,080,000 first-time buyer purchases and 320,000 buy-to-let house purchases. Over the following 5-year period (2014-18), there were 1,690,000 first-time buyers and 460,000 buy-to-let purchases, suggesting no crowding out of first-time buyers.

1.3 Latest regulatory interventions

2019 has not seen a let-up in the pace of new regulation in the PRS. The latest regulatory change is the Tenant Fees Act (2019) which came into effect on 1 June. It prohibits letting agents and landlords from charging a range of fees and puts a cap of five weeks' rent on deposits and one week's rent on holding deposits. For landlords, the most concerning aspect is that if any charge or deposit is above the prescribed ceiling (even by a few pence) they could potentially lose the right to give notice under Section 21.

But potentially more significantly, the government has announced a consultation on a proposal to abolish Section 21 of the 1988 Housing Act – the so-called 'no-fault eviction' clause in ASTs. Under Section 21, a landlord can give two months' notice that he/she does not wish to enter into a new AST on termination of the existing contract. In effect it amounts to an absolute right to regain possession of the property at the end of the tenancy.

The proposed abolition of Section 21 has caused considerable disquiet amongst landlords. One reason for this reaction is that Section 21 provides the most efficient mechanism for removing tenants with arrears or those exhibiting anti-social behaviour. By comparison, landlords report that obtaining an eviction order for rent arrears or damage can be a much more drawn-out process, open to manipulation by tenants who wish to extend their stay without complying with their contractual obligations.

1.4 Towards a more professional PRS

The increased regulation of the PRS would be expected to impact smaller providers hardest, as they have the least resources to meet the cost of complying with new rules. And lenders report that this has indeed been the case, with many small-scale landlords selling up while some larger landlords have taken the opportunity to selectively increase their portfolios.

Alongside this, the government's Build-to-Rent initiative, which has provided financial support to institutional investors in new PRS developments, has boosted professional management. According to the British Property Federation (BPF) there are currently 140,000 Build-to-Rent units either completed or planned across the UK, equivalent to 3% of the PRS, a number that has grown rapidly in recent years.

Government statements suggest that a more professional PRS is not just a by-product of other policies, such as the promotion of homeownership and increasing the supply of newly build PRS properties, but is a policy objective in its own right. The government is hoping that the Build-to-Rent sector will set a high standard of accommodation that other landlords will seek to emulate. However, Build-to-Rent providers have focused mainly on the higher end of the rental market, with rents that many PRS tenants find unaffordable. In the mid-priced segment of the market, smaller and medium-sized landlord businesses including buy-to-let investors still dominate.

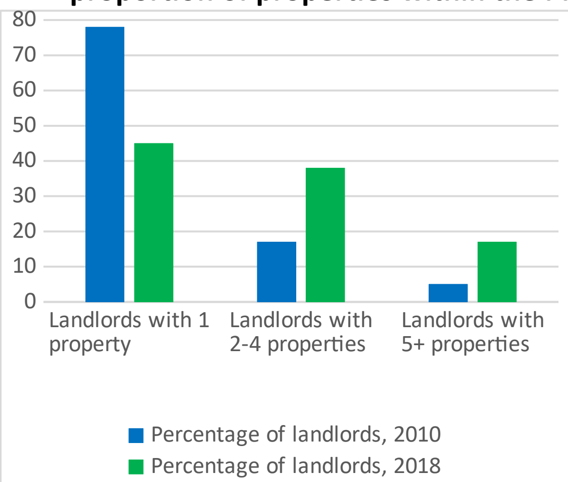
1.5 Characteristics of landlords

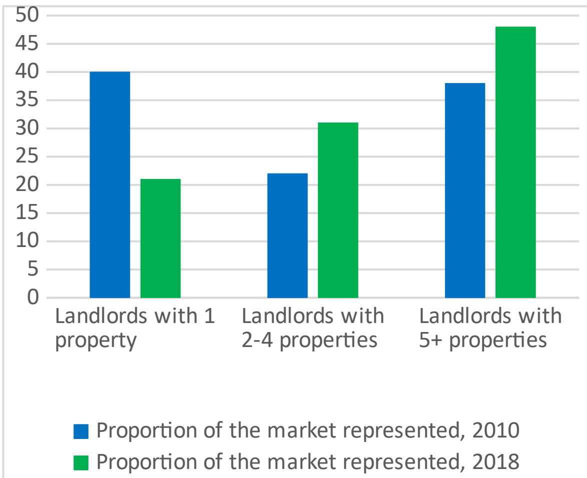
How successful has government been at professionalizing the PRS? We can answer this question using the English Private Landlord Survey published by the Ministry of Housing, Communities & Local Government (MHCLG). The most recent survey relates to 2018 and shows that the PRS remains dominated by small and medium-sized landlords.

The survey found that 45% of landlords have just one rental property, representing 21% of the PRS. A further 38% own between two and four properties (representing 31% of the sector). The remaining 17% of landlords own five or more properties, representing 48% of the private rented sector.

However, ignoring methodological differences in the survey, since 2010, the proportion of landlords with just one property has declined from 78% to 45% or from 40% to 21% of the private rented housing stock. Meanwhile, the proportion of landlords with five or more properties increased from 5% to 17% or from 39% to 48% of the housing stock (see Charts 3 & 4). This is quite a large shift away from the smaller scale landlord towards medium-sized rental businesses.

Charts 3 & 4: Percentage of landlords by number of properties owned and by proportion of properties within the PRS





Source: MHCLG, English Private Landlord Survey, 2018 and Private Landlords Survey, 2010

But the survey shows that despite the shift towards larger portfolios, few landlords have incorporated despite the potential tax benefits from doing so. It shows that 94% of landlords rent property as an individual, 4% through a company and 2% as part of some other organisation, although lenders report that, for house purchase buy-to-let borrowing, the proportion of landlords using limited companies is much higher. For example, Precise Mortgages reports that 64% of landlords with more than four properties who plan to buy this year will use limited company status.

The English Private Landlord Survey also showed that the use of buy-to-let finance was found to be higher amongst more established landlords. 49% of those who had been a landlord for three years or less had a buy-to-let mortgage to fund their current property/ies, increasing to 58% of those who had been letting for between 4 and 10 years. This perhaps reflects the existence of accidental landlords who are letting properties out for shorter periods of time and do not use a buy-to-let mortgage. If the smallest scale landlords continue to retreat as a share of the total, buy-to-let could outperform the wider PRS in terms of growth, given the higher use of buy-to-let debt by more established landlords.

2. Interplay of the PRS and buy-to-let sectors

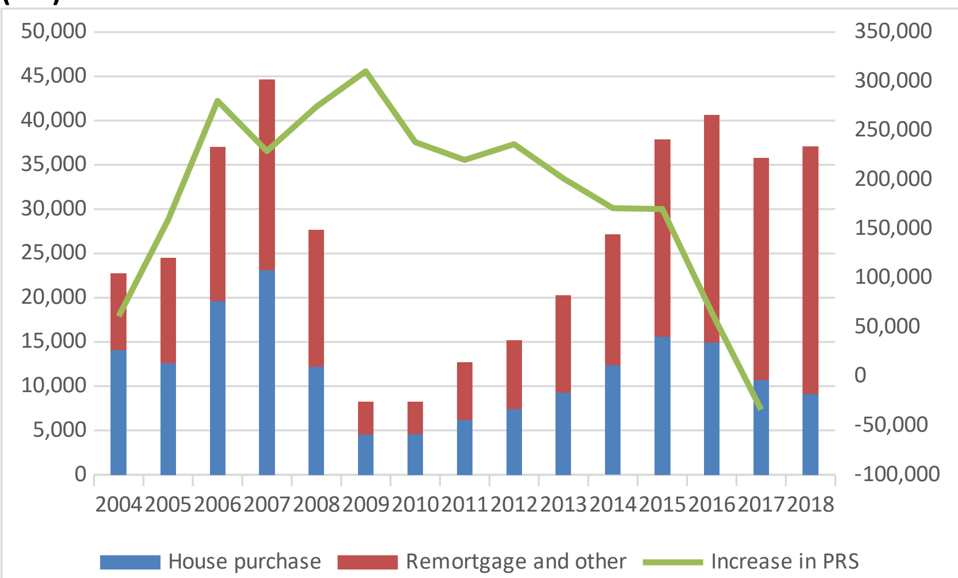
2.1 The disconnect between buy-to-let and the wider PRS

It might seem reasonable to expect the buy-to-let sector to reflect changes in the wider PRS. Although only 35% of PRS properties have an outstanding buy-to-let mortgage, there is no doubt that the smaller and mid-sized landlords that buy-to-let loans were designed to cater for have been the driving force behind the expansion of the PRS since the late 1990s.

For the first decade after lenders launched the buy-to-let mortgage in 1996, the relationship between buy-to-let and the wider PRS seemed quite clear. Between 1996 and 2006 the PRS increased by 1 million units and outstanding buy-to-let loans grew to 840,000. Yet since the financial crisis, the evolution of the two segments has diverged.

As Chart 5 shows, buy-to-let lending suffered a severe contraction during the financial crisis of 2008-9. Indeed, the contraction was more pronounced than with broader mortgage lending, with gross lending falling 81% between 2007 and 2009, against a fall of 57% for regulated lending. Yet this was a period when the PRS was expanding at a record pace. The green line in Chart 5 shows the increase in the size of the PRS, and in 2008 and 2009 alone the sector added 584,000 properties while the stock of properties with a buy-to-let mortgage grew by only 221,000.

Chart 5 – Buy-to-let gross mortgage lending in £ million (lhs) and growth of PRS (rhs)

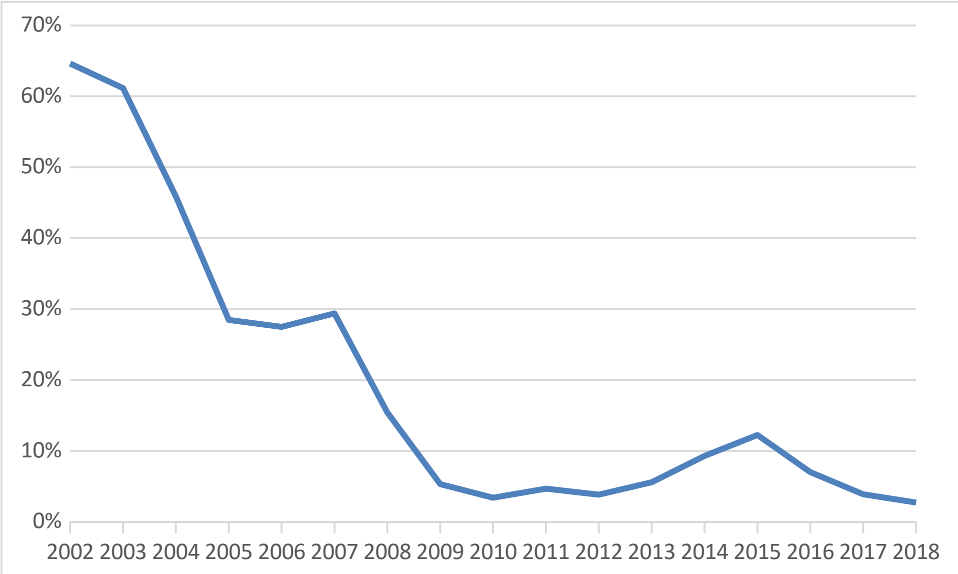


Source: UK Finance

After 2009, buy-to-let lending for house purchase recovered robustly, rising from £4.5 billion to £15.6 billion in 2015, yet the rise in the size of the PRS slowed markedly. Only since 2015 has the direction of travel of the two sectors once again coincided, with a decline in buy-to-let lending for house purchase mirroring a slowing in the growth of the PRS in 2016 and a decline in 2017.

It is unclear why the evolution of the PRS and buy-to-let sectors did not match over the past decade. The rise of the PRS during the financial crisis might have been due to some owner-occupiers renting out their homes and moving in with relatives to provide extra income after losing their job but this may not be the whole explanation. Government data on the size of the PRS may also not be fully robust, given the difficulties identifying properties that are moving between the owner-occupied and private rented sectors.

Chart 6 – % increase in buy-to-let mortgage debt outstanding



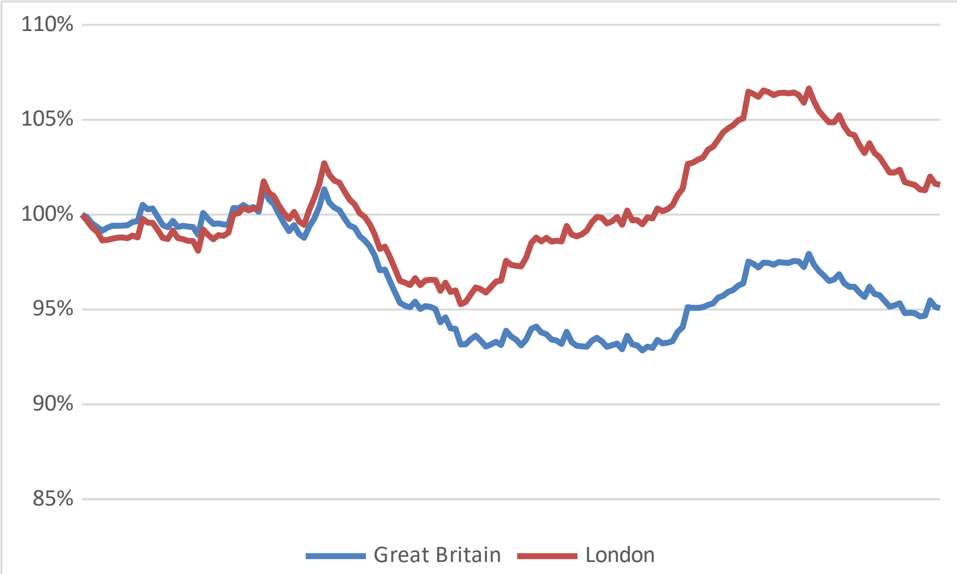
Source: UK Finance

But what Chart 6 shows is that buy-to-let as a lending segment has matured. It can no longer enjoy the stellar growth rates of its early years now that the sector covers close to 2 million properties with outstanding mortgage debt of £244 billion. But whether buy-to-let shows modest but healthy growth or sees a squeeze in the size of outstanding debt in real terms will depend, above all, on the direction of government policy and whether landlords feel that they will be able to achieve an adequate return against the background of these polices.

2.2 The balance of supply and demand

One key measure of the health of the PRS and the extent to which supply is able to meet tenant demand is rental prices. Chart 7 shows rents in real terms (adjusted for CPI inflation) since 2005 for Great Britain. This series shows that since mid-2009 rents have failed to keep pace with inflation with a cumulative fall of 5% over a decade, suggesting a healthy level of supply. London has seen more pressure on rents since the financial crisis though, even here, real rents have fallen back about 5% since 2016.

Chart 7 - PRS rents adjusted for CPI inflation (Jan 2005=100)



Source: ONS

Some commentators have taken the performance of real rents since 2015 as proof that policies that increase taxes and regulations on landlords have not negatively impacted the rents that tenants pay[1]. However, we would caution against drawing such a conclusion. Firstly, data on the size of the PRS do seem to confirm that the measures announced since 2015 have slowed and then reversed the growth of the PRS. So the lack of growth in real rents may reflect a similar weakness in demand. Since the referendum on leaving the EU in June 2016, there has indeed been a sharp fall in net immigration and some experts claim that difficulties tracking EU citizens leaving the UK mean that the immigration reversal could be even more substantial.

Secondly, the ONS rental data track the rents paid by a sample of existing tenants rather than tracking the price of new rental contracts. There is some evidence that for new contracts rents are beginning to pick up, most notably with Rightmove's Rental Price Tracker which shows that average asking rents in London, which should be a leading indicator, increased by 8.2% in the year to Q1 2019.

[1] See for example "Do measures that discourage buy-to-let investment increase rents?" A Generation Rent paper by Dan Wilson Craw (October 2018).

3. The outlook for the PRS and buy-to-let

3.1 Developing scenarios for the PRS

As we have stated above, the evolution of housing tenures in the UK has always been dependent to a large extent on government policy. Although market forces and household preferences have an important role in determining outcomes, government policy impinges on housing choices in myriad ways. For example, the overall supply of housing is constrained by planning regulations. Clearly, UK housing supply would look radically different if there were no planning controls.

Beyond its role in determining overall supply, government impacts housing outcomes through tax policies, regulation and the degree of subsidy it provides to tenants in social housing and the PRS through housing benefit. So in creating a projection for the future size and shape of the PRS the most significant explanatory variable should, in our view, be current and future government policy. Therefore, we outline four scenarios for the PRS up until 2030 based on four policy projections:

Scenario 1

Current policies remain broadly unchanged.

Scenario 2

Rent 'stabilization' is introduced for current tenants.

Scenario 3

'Hard' (nominal) rent controls are imposed across the PRS.

Scenario 4

Government rethink of current tax and regulatory stance in response to signs that the PRS is suffering from the changes enacted since 2015.

For a detailed modelled projection of the PRS we can draw on *The Future Size and Composition of the Private Rented Sector*[2]. In their statistical modelling, the authors concluded that the variables that affected the size of the PRS all related to households' capacity to enter owner-occupation. They presented four scenarios based on different macroeconomic outcomes out to 2028. We have used their analysis to inform our view on how the PRS may evolve, but rather than using different economic scenarios to determine the future evolution of the PRS, we think it is more appropriate to use different policy paths as the key explanatory variable in each scenario.

[2] "The Future Size and Composition of the Private Rented Sector" An LSE London project for Shelter. Chihiro Udagawa, Kath Scanlon and Christine Whitehead (May, 2018)

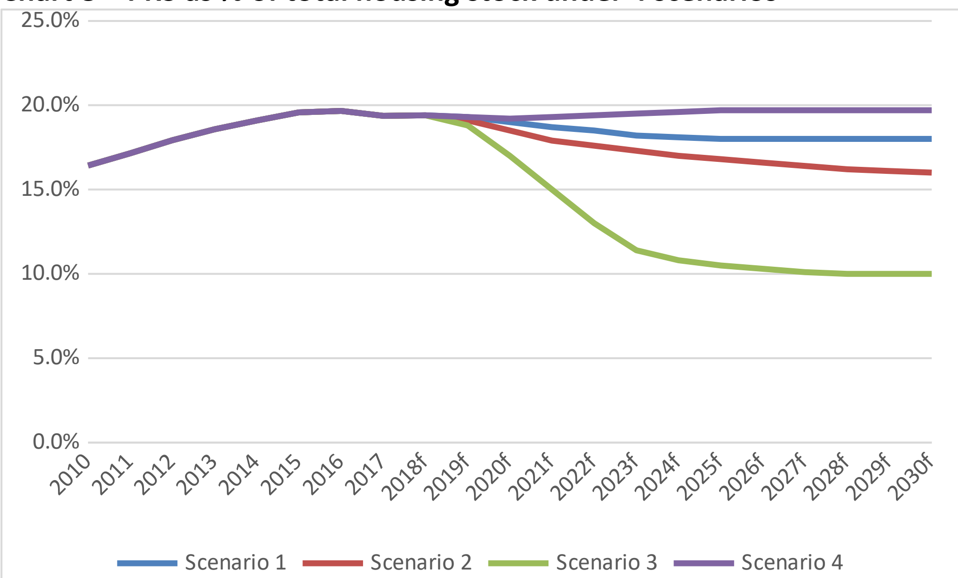
3.2 Scenario 1 – housing policies broadly unchanged

Since 2015, tax and regulatory changes have disadvantaged private landlords. Perhaps the most significant change, the reduction in tax deductibility of mortgage interest, is not fully implemented until 2020-21. Moreover, the 2018 English Private Landlord Survey shows that many landlords remain unaware of some key tax changes, with 33% not aware that the interest tax deduction is being restricted to the basic rate. As a result, even if there are no new tax increases or regulatory interventions, the market is still absorbing the adverse changes already in train and can expect a period of softness for at least the next 2-3 years.

The 2018 English Private Landlord Survey also showed that of those landlords planning to sell some or all of their properties, 61% cited legislative changes as the reason. Landlords using a buy-to-let mortgage were more likely than landlords using other kinds of loans or no loans to report planning to decrease or sell their rental property due to legislative changes (70% of buy-to-let landlords, compared to 52% with another kind of loan and 34% with no loans).

However, tenant demand is likely to be sustained based on strong ONS demographic projections so, in the absence of a major social house building programme or much lower immigration, we would expect the PRS to stabilize at around 18% of the housing stock, as illustrated in Chart 8. Assuming that the total housing stock grew by 230,000 a year over this period, the PRS would increase in size by 160,000 by 2030.

Chart 8 – PRS as % of total housing stock under 4 scenarios



Source: IMLA projections

3.3 Scenario 2 – rent 'stabilization'

This scenario would see a future government introduce a form of rent control this is sometimes referred to as rent 'stabilization', as well as maintaining the current adverse tax and regulatory changes. This form of rent control would allow new tenancies to be set at market rents but would not permit landlords to raise rents on existing tenancies faster than some measure of inflation (such as the RPI or CPI). Capping rent increases at inflation would adversely affect landlords because it would prevent them from benefitting fully from strengthening rental demand unless they were in the market for a new tenant.

Any government that introduced rent stabilization might well feel it needed also to abolish no-fault evictions, as changing tenant would be seen as a way that landlords could circumvent the policy when market rents were rising fast. Landlords would perceive the introduction of rent stabilization and the abolition of Section 21 as harmful interventions. But in practice rent stabilization would have a fairly modest effect on most landlords' incomes as average UK private sector rents have generally lagged wider inflation, as illustrated by Chart 7. As a result, we would expect the PRS to shrink faster than under scenario 1 but relatively modestly so to reach c.16% of the housing stock by 2030. Under this scenario, the PRS would shrink by 460,000 units between 2017 and 2030.

This scenario is close to the proposals outlined in *Land for the many - Changing the way our fundamental asset is used, owned and governed,* produced by the Labour Party (June 2019)[3], although this document goes somewhat further and proposes that rents are capped at the lower of inflation or wage increases and that Council Tax is replaced by a tax payable by the owner rather than the tenant. If rent controls were introduced first, landlords would find themselves unable to pass on the cost of this new property tax in higher rents for existing tenants who were no longer meeting the cost of Council Tax.

3.4 Scenario 3 – hard rent controls

This scenario would see hard rent controls introduced across the mainstream PRS. This would mean that tenants would see their rent capped at current nominal levels indefinitely or that a government body was established to set 'fair' rents as occurred under the Rent Act 1977[4]. Any government introducing such a policy to protect tenants against any rent increases would presumably see the need to couple it with policies restricting the right of eviction to make it effective. If landlords were still able to end a tenancy by, for example, selling the property or temporarily moving in as they are under the new Scottish Private Residential Tenancy, policymakers might fear that landlords would use this right to circumvent rent controls.

To ensure that tenants could benefit from controlled rents and security of tenure the government would likely see the need to introduce indefinite tenancies, which

[3] Authorsed by George Monbiot (editor), Robin Grey, Tom Kenny, Laurie Macfarlane, Anna Powell-Smith, Guy Shrubsole, Beth Stratford.
[4] Scotland has already introduced the concept of 'fair' rents as tenants have the right to appeal a rent increase to a rent officer although this only relates to an increase in rent not the level of rent.

would not only remove Section 21 'no fault evictions' but also remove the landlord's right to evict in order to sell or move into a property. The combination of controlled rents and indefinite tenancies (or sitting tenancies as they were once termed) would reduce the potential future value of rented property.

Landlords would face the prospect of rents falling continuously in real terms, which would also create the likelihood of capital values falling indefinitely. This worst-case scenario for landlords would likely lead to a substantial exodus (see Chart 8) which, ironically, would cause a serious shortage of housing for tenants and more empty properties, where for example owners working abroad for a few years would fear they would be unable to get their property back from a sitting tenant. It would also no doubt create a larger black market of entirely unregulated rental properties hidden from the authorities.

A future government that sought to introduce hard rent controls may also seek to invest heavily in the social rented sector to provide lower income families with a cheaper alternative to the PRS. This could help to contain the rise in PRS rents, which would be positive for tenants in that tenures. However, it would further undermine the investment case for landlords and, in practice, it would take years to implement in scale, causing a prolonged period of disruption for tenants from rent controls before the benefits of more social housing could come through.

We would place an extremely low probability on hard rent controls being imposed, as Labour Party policy documents such *as Land for the many* have advocated rent stabilization instead, albeit combined with other policy proposals that would raise landlords' costs such as compulsory registration, a property 'MoT' and the introduction of a property tax borne by owners rather than occupiers. However, we are concerned that less draconian policies that undermine the investment case in the PRS will drive up rents, which might, ironically, push a future government into the more extreme solution of hard rent controls.

3.5 Scenario 4 – return to a market orientated policy for the PRS

Under this scenario, we envisage a government that accepts that the adverse tax and regulatory changes of recent years have harmed the PRS. Such a policy reversal did occur in the Irish Republic, when the decision to remove the tax deduction of mortgage interest was reversed because it was seen to lead to higher rents that hurt tenants. Such a policy reversal could allow the PRS to rebound slightly to around 20% of the housing stock, but if it was coupled with policies to help first time buyers it could be consistent with a stable PRS growing only in line with the overall housing stock and a healthy owner-occupied sector.

3.6 Impact on buy-to-let market

Policies that undermine confidence in the PRS are likely to have a disproportionate effect on the smaller investors who have been the backbone of the renaissance of the sector since the 1990s. Larger, corporate landlords will have the resources to develop strategies to combat greater regulation, although even they would find hard rent controls highly problematic.

As buy-to-let lending has focused on small-to-medium-sized letting businesses, increased regulation might be expected to impact buy-to-let more forcefully than the broader PRS. However, buy-to-let lending has already evolved as some of the landlords who entered the market using buy-to-let finance now have quite substantial rental businesses. Lenders report that these portfolio landlords make up an increasing proportion of new business. And they can generally be contrasted with the much larger corporate landlords because they have mostly remained family businesses, retaining a modest cost base.

In contrast, institutional investors in the PRS have struggled to keep costs low enough to compete in the mass rental market. Instead, they have targeted tenants who can pay for a premium product by building apartment blocks with facilities such as gyms and cinema rooms. Tenant affordability constraints limit this market, so that buy-to-let landlords, albeit increasingly those who have built larger businesses, are set to remain a vital part of the PRS, meeting mass market housing need. As a result, the buy-to-let sector could outperform the wider PRS in terms of future growth even though it is now a mature lending segment.

4. Conclusion

The UK has gone from having an under-sized PRS by international standards in the 1980s and 1990s, to having a PRS of around 20% of the housing stock today, in the middle of the scale amongst European countries. On the face of it, this does not seem unhealthy. After all, the PRS does provide the most flexible accommodation, allowing people to move more easily for work or other reasons than those in the social rented or owner-occupied sectors.

However, the growth of the PRS must be placed into the broader context of housing market developments to understand the perceptions of PRS tenants and the wider political climate. The social rented sector has seen limited investment, which has pushed many lower income households into the PRS, which offers lower security of tenure. At the same time, rising house prices and more stringent mortgage regulation have made it harder for many younger households to enter owner-occupation, while aspirations to buy remain high.

All this has created a situation where many people find themselves in the PRS not out of choice but due to a lack of other options. Despite this, tenant satisfaction surveys are quite positive for the PRS: in the 2016-17 English Housing Survey, 84% of private renters were satisfied with their current accommodation and 68% with their current tenure. Although this latter figure is lower than with owner-occupation and social renting, it has improved in recent years, but it does not change the political reality that many tenants would prefer to be in a different tenure.

Since 2015, the Conservative government has responded to concerns that a disproportionate number of young households are unable to buy their own home through tax and regulatory measures that disadvantage landlords, in an attempt to encourage a shift in properties from the PRS to owner-occupation. The latest data on housing tenure in Great Britain seem to confirm that this policy objective is being achieved as owner-occupation is again expanding at the expense of the PRS.

However, a reduction in PRS supply has implications for those tenants who cannot afford to buy. Their rent is likely to rise and some rental indices suggest that this process is already underway, particularly in London. We are concerned that, with such a strongly negative political sentiment towards the PRS, a rise in rents driven by reduced rental supply resulting from government measures raising landlord costs, will not cause a re-think on current policies but rather will create political pressure to control rents instead. Rent control could cause a much larger exodus of private landlords if introduced in its harder form, which would exacerbate the housing shortage for tenants.

When looking to the future of the PRS, we believe that government policy will have the most significant impact. So, when constructing different scenarios for the next decade, it is the type of government interventions that we see as critical. If policies remain broadly unchanged, we see the PRS shrinking slightly and then stabilizing at c.18% as the market adjusts (for example, via the switch to corporate ownership structures where interest remains tax deductible). If we see rent 'stabilization' – where rents are permitted to rise in line with a price index during tenancies and are set by the market at the start of each tenancy, the impact on supply could be relatively contained, leading to a decline in the PRS to perhaps c.16%.

If, however, we moved to 'hard' or nominal rent controls coupled with tenants being given the right to remain indefinitely, the impact on the PRS would likely be severe. Such a policy would have to be coupled with a large expansion of the social rented sector to prevent widespread homelessness but, even then, many more homes would likely be left empty – for example, where the owner was working abroad for a few years and feared being unable to recover their home from tenants on their return. We consider the scenario of hard rent controls to be extremely unlikely but it is worth reminding ourselves of the potential harm it would cause, not least to private tenants.

There is however another scenario: that a future government recognizes the importance of a vibrant PRS and the benefits of allowing the market to work more efficiently in the sector and rethinks some of the adverse tax and regulatory changes seen since 2015. Such a policy rethink could be coupled with policies to help more first- time buyers into the market and maintain new build output. This could ensure an appropriate balance between the PRS and the owner-occupied sector that most households aspire to.

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About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses via the broker channel. Its membership unites 42 banks, building societies and specialist lenders, including 19 of the 20 largest UK mortgage lenders responsible for £230bn of annual lending.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market.

Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), UK Finance and the Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high-profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.