# Chapter 3
# Private housing

With housing associations already moving back into the private sector in England, at least in official terms the private housing market has once again grown and the public sector has shrunk. What this highlights is the fragility of our definitions as to what is public and what is private. It is also clear that the distinctions between sectors and tenures are becoming more blurred, with products such as shared ownership and Rent to Buy crossing the divide by combining features of both tenures. Similarly, the lifetime mortgage market is expanding and although ownership formally sits with the borrower the reality is they make mortgage payments equivalent to rent for their whole lifetime.

In this chapter we explore developments in both the owner-occupied and private rental markets – the latter having become ever more significant over the life of the *UK Housing Review*. Now in some respects it is a competitor to the homeownership market, rather than having the role it played in the three decades from the 1960s – the provider of cheap homes ripe for gentrification as landlords exited the sector because of low demand and poor returns. It is now the health of both sectors that is crucial to the overall functioning of the market, not least given the contraction of social housing as a provider of affordable homes.

## How balanced is government support for the private sector?

Government policies have both driven and reflected these changes, favouring private rented housing and/or homeownership to different degrees over time, although this is less the case in Scotland or Wales where policy has perhaps more consistently favoured the social housing sector. As we show in Table 2.4.1 (page 60), government is now supporting a wide spread of initiatives across the private housing market whether directed at housebuilders, lenders, investors, landlords or homebuyers.

In a currently unpublished review, Wilcox and Williams explored the overall level of 'subsidy' provided to each of the three main UK tenures.[1] We accept that like-for-like comparisons are very difficult, as they have to take into account not just capital subsidy but recurrent revenue subsidy (e.g. housing benefit), equity loans which are not treated as expenditure, guarantees, etc. It is a complex challenge to arrive at figures which genuinely show the overall position for each tenure.

Nevertheless this crude assessment concludes that homeownership is the most 'subsidised' tenure, followed by social housing and then the private rented sector.

In summary, the overall impact of residential property taxation is that in net terms (taking tax reliefs away from tax paid) the *homeownership sector* benefits to the tune of more than £29 billion per year, added to which it is now receiving more than £5 billion of government support per annum, albeit much of this is in the form of loans and guarantees. In crude terms the homeownership sector is 'ahead' by around £34 billion per year – adding all types of funding together.

By contrast the *private rented sector* pays over around £8-9 billion per year to the UK government through the tax system. It currently gets back less than £1 billion of funding support for new development, in the form of loans and guarantees, and also receives around £9 billion per annum in housing benefit payments. Therefore in these very crude terms the position of the private rented sector is currently financially neutral; but the ending of the private rented sector guarantee scheme[2] and new taxes now being introduced will see the balance tipped, so that the sector becomes a net contributor.

This highlights the government's very heavy emphasis towards supporting homeownership. Within that there is also a clear intergenerational divide, with the net gains from tax reliefs largely accruing to older and long-established owners, while the equity loans and other policy measures are primarily focused on younger first-time buyers. In one sense these different strands of financial support might be said to cancel each other out, even if their costs to government are cumulative.

These two private sector comparisons are instructive. So too is the comparison with the *social rented sector* where the position is equally complex. If housing benefit and support for social sector housing investment alone are counted then the subsidy currently amounts to some £20 billion per annum. However, it can be argued that housing association borrowing at preferential rates reflects an implicit government guarantee, estimated to reduce the rate by one percentage point. If as well as this we also take into the economic subsidy from sub-market

rents (albeit partly dealt with via capital subsidy) and (perhaps controversially) the value of section 106 obligations, then the total subsidy rises towards £30 billion per annum.

Thus in terms of financial support in the broadest sense the private sector is getting close to £38 billion per annum, in contrast to the public sector – social housing – getting some way towards £30 billion. Given that private renting is – in crude terms – subsidy-neutral, the overall conclusion is that homeownership is the most subsidised sector, albeit stressing that this assessment uses a very broad definition of what counts as 'subsidy'.

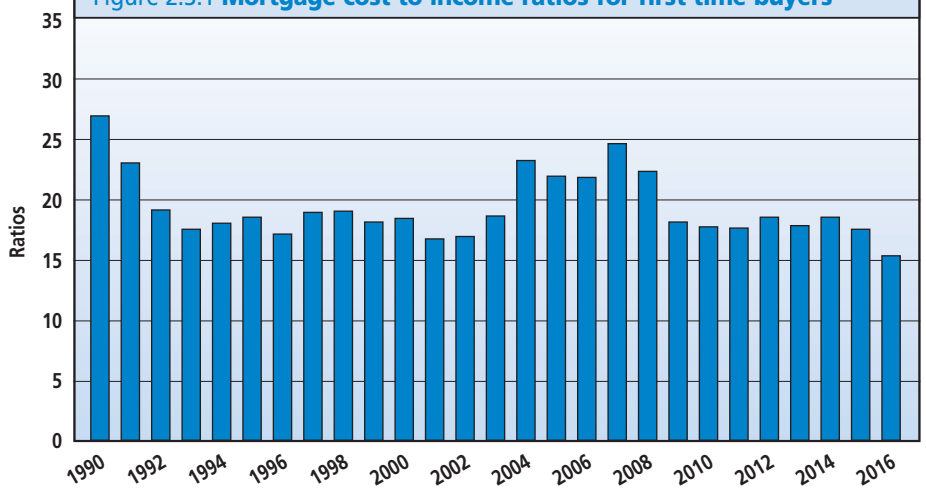
## Contrasting fortunes – a healthy homeownership market?

Despite this level of support and as we have highlighted in previous editions of the Review, homeownership in the UK has been facing considerable challenges, illustrated by Table 1.1.1 (page 14) which highlights the decline in first-time buyer numbers over the period 1986 to 2016. Until 2005, homeownership across the UK was still increasing (peaking at 69.1 per cent of dwellings in England in 2004, 75.1 per cent in Wales in 2005, 65 per cent in Scotland in 2008 and 73.2 per cent in Northern Ireland in 2004, see Compendium Table 17). But it has since declined, especially after the 2008 financial crisis, with patterns of ownership marginally closer across the UK than before[3] though still with Wales (69.8 per cent) and Northern Ireland (65 per cent) at higher levels than England (62.3 per cent) and Scotland (60.7 per cent). We have seen a decline in the number of mortgaged owners and a rise in outright ownership reflecting the emptying out at younger age groups.[4] On any house-price-to-income measure, affordability has worsened along with the deposit gap.

However, more positively, on the basis of mortgage-cost-to-income ratios the situation has improved (See Figure 2.3.1 ) as a consequence of historically low interest rates, and despite the modest increase in the Bank Rate (to 0.5 per cent, the first rise since 2009) competition has kept mortgage costs low.

With a house price outlook of perhaps a one or two per cent increase in 2018 we are seeing real terms falls in house prices, which may ease the costs of entry for

Figure 2.3.1 **Mortgage-cost-to-income ratios for first-time buyers**




Source: Compendium Table 42a.

some households. As discussed in Contemporary Issues Chapter 1, first-time buyer numbers have risen while the number of moving homeowners has declined – many preferring to stay put and improve or extend their homes rather than face the cost of buying another home and pay the substantially increased stamp duty. As this suggests, in conventional terms the homeownership market is under-performing with reduced transactions and slowing prices.

## Contrasting fortunes – where now for the PRS?

It is now becoming clearer that the buy to let market is undergoing important changes flowing on from the tax changes that emerged in the 2015 Summer Budget – tax reliefs reduced, stamp duty increased relative to homeownership and capital gains tax kept at 20 per cent unlike other asset classes. This was all part of Chancellor Osborne's anti-small landlord and buy to let stance, something that has softened a little under Philip Hammond. Nevertheless a gradual tightening of the market has been evident. In Scotland, a new, universal form of tenancy and other reforms were introduced in December, giving much greater security of tenure. In England, somewhat belatedly and more modestly, new measures include a ban on letting agent fees being charged to an existing tenant when they sign a

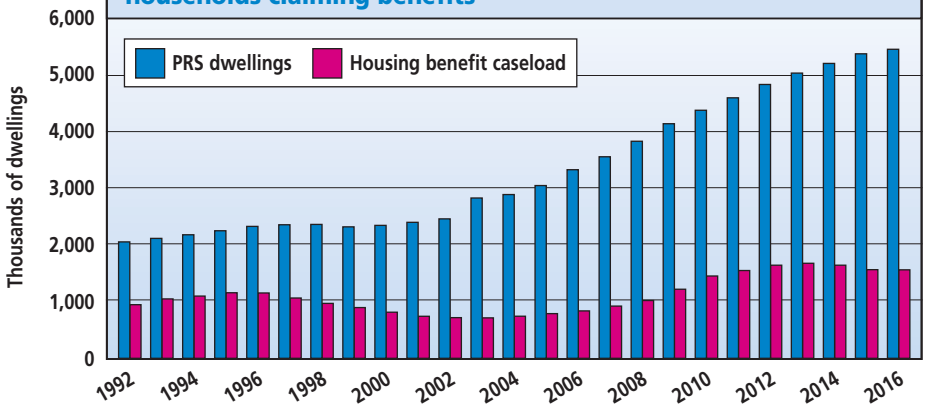
new tenancy agreement, the licensing of homes occupied by five or more people and from two or more households, and new powers under the Housing and Planning Act 2016 to crack down on rogue landlords.[5] Local authorities can now impose civil penalties of up to £30,000 as well as prosecute, along with extended Rent Repayment Orders, although much of this new regulatory action may be stymied because of local authority cuts in enforcement services. In addition the Prudential Regulation Authority is imposing much stricter underwriting criteria and stress tests similar to those in the homeownership market, while late in 2017 tighter underwriting standards were also introduced for portfolio landlords (those with four or more properties).

Reflecting this new context, the growth rate of the private rented sector has slowed from eight per cent in 2014 to two per cent in 2016 and the number of new buy to let mortgages has fallen from around 10,000 per month to 6,000 a month. Yields have fallen too, reflecting the fact that prices have risen faster than rents which have edged down with increased competition in the sector.

Alongside these tax and regulatory changes, the potential demand for PRS homes from low-income households has been constrained by the policies of lowering and then freezing the levels of local housing allowances. Since 2013 the numbers of claimants in the sector have been declining: in 2016 they represented 29 per cent of all households in the sector, compared to one-third in 2013 – and over half of households in 1995 (see Figure 2.3.2).

This somewhat more negative context has prompted Nationwide Building Society to set up a new cross-industry Partnership Board to help landlords deliver decent, affordable homes. This board is backed by the National Landlords Association (NLA), the Association of Residential Letting Agents (ARLA), Shelter, Countrywide and The Nationwide Foundation. It will monitor the health and development of the private rented sector, discuss issues of mutual concern and provide policy suggestions to government. Nationwide's buy to let subsidiary commissioned a YouGov survey of 1,000 landlords in mid-2017: this showed that almost a third (29 per cent) had never increased their rent but that in the light of the changes coming through:

Figure 2.3.2 **Rapid growth of PRS but proportionate decline in households claiming benefits**




Sources: Stock data: UK Housing Review; housing benefit data: DWP website.
Note: Data are for Great Britain. Housing benefit figures for 2015 and 2016 include universal credit cases.

- more than two in five (44 per cent) are now considering increasing rents – if they can
- one in ten (10 per cent) will reduce the amount they spend on property maintenance
- one in seven (14 per cent) plan to manage the property themselves, rather than use an agent
- a fifth (22 per cent) are considering selling their rental property.

This picture of retrenchment is reflected in a number of other surveys.[6] The recent RICS forecast for 2018 highlighted members' expectations that there would be more exits from the sector than entrants.[7] Limited evidence does suggest portfolios are being reworked, with sales focussed on low return/high cost units and where replaced these are in less costly areas where the price/yield comparison is more favourable. As the RICS notes, this does have implications for affordability – rental growth has been positive (for landlords) but slowing, reflecting flat demand especially in London (in part because tenants are unable to meet the rents being asked). However, over the next two years the RICS expects rental growth to strengthen and outstrip prices, resulting from a forecast fall-off in supply prompted by the changes just discussed.

## Outlook for Build to Rent

By contrast we have a very bullish outlook for the Build to Rent sector, a strong favourite of government in England as it promises to deliver new homes and be run in a more professional way. 2017 saw the launch of a major report on the sector.[8] This highlighted the spread of active participants as developers and investors – including for example a number of medium to large housing associations – and the scale of current and planned output. As of September 2017, 95,918 units were completed, under development or have planning permission in the UK – of which 54,978 were in London. With investors keen to embrace residential real estate at the moment, the expectation is for this momentum to continue. As a recent IPF update shows, mainstream investor exposures to housing and student accommodation have grown rapidly in the last five years, up 31 per cent to £38 billion in 2016.[9] This was far greater than both the rise in major investor exposure to commercial property and the increase in the size of the total private rented sector stock. However, it is worth remembering that with private renting having over five million homes in total this new sector has a long way to go before it becomes a major player overall.

## The overall private market outlook

Looking ahead to 2018 we see the housing market slowing, as a result of modest wage growth, rising interest rates and the general decline in consumer confidence. House price inflation in 2018 is likely to be in the region of one per cent (i.e. a real-terms reduction), albeit with strong regional and local variations, then rising to around two per cent in 2019. This is very much in line with other commentators who then see acceleration through 2020 onwards in line with earnings. There is a case for a more cautious stance on this given the recent commentary on diminished wage growth and interest rate trends (not least as the Bank raises rates and withdraws from the term funding scheme which has supported very low mortgage rates), but the demand and supply imbalance continues and this in turn generates price pressures. The market expectation is that transactions will remain flat at around 1,200,000 per annum for the next two years and that the market will be well supported by good mortgage availability and pricing.

The OBR has recently published its housing supply forecast showing increased output up to 2021, with the government coming close to meeting its supply targets.[10] Aside from the uncertainty surrounding Brexit and what happens to the pound – itself quite a key driver in terms of foreign investment in the UK property market – there is the added unknown of what happens to the Help to Buy equity loan scheme post-2021. This has been an important prop to housing output and to increased first-time buyer access to the market. Getting clarity as to what happens after 2021 is going to be an important conditioning factor in terms of prices and transactions for 2022 onwards. The recent removal of stamp duty for first-time buyers on properties up to the value of £300,000 (in England, Wales and Northern Ireland) is itself a not inconsiderable boost to the market, with government estimating that some 205,000 first-time buyers will benefit in 2018/19 though the number of additional households who could not otherwise have bought is likely to be much smaller. There is a likelihood that to a degree the exemption will be capitalised into higher house prices, thus benefitting existing owners rather than new buyers.

As this suggests, there are multiple effects working through the market which will find expression over the next two years. The fan diagram of uncertainty is very wide. What is very clear is that there is not likely to be a market collapse even though we are some considerable way through the normal property cycle and that the most likely prospects for 2018 and 2019 are for 'more of the same'. Much turns on what happens to the London market which might bear the brunt of Brexit, and how this ripples out to other markets, if at all. Early evidence does suggest that the slowing in central London is now being reflected in a slowing in linked outer London markets.

## And the balance of tenures?

With buy to let purchase numbers remaining flat, the question then is can Build to Rent make up some of the difference and how far will tax incentives for first-time buyers (i.e. reduced stamp duty) help that sector overtake a possibly flagging PRS? Although the government in England is arguing it has halted the decline of homeownership, there is little evidence to date that a strong recovery is underway.

We might therefore expect some numerical growth in line with household growth but the homeownership percentage is more likely to remain static, with the negatives in the market offsetting the positives. Compendium Table 31 shows the sharp decline in the last decade in young households buying with a mortgage and the consequent increase in use of the PRS by the same households, a pattern which will be difficult to reverse.

In terms of private renting, part of the question is what alternatives exist for investors if they do wish to exit the sector. The stock market recovery has been strong and this might provide one alternative but the outlook is uncertain there, just as it is in the residential market. First-time buyers may be better able to outbid investors in the market and there is already some evidence that competition between the two sectors has weakened.[11]

Social housing is likely to grow but again the question is whether we see any shift in the overall balance of tenures. On the basis of current statements and spend this seems unlikely. We will see a more diverse housing market with more shared ownership, shared equity, community land trusts and the like but these are unlikely to challenge the main tenures as they stand. All in all the balance of tenures will probably remain fairly static for the next few years albeit that the cohort effect of reduced ownership will be working its way through. Depending upon Brexit and how the macro-economy evolves, we could see a modest recovery in homeownership albeit the regulatory frameworks now in place do put a fairly hard boundary around it.

Finally in closing, and as the recent systemic review of housing statistics makes clear,[12] our ability to track the private market's operations across the UK is inhibited by gaps in data provision, most notably about the private rented sector. We have a patchwork of data which limits how well we can paint the overall picture. This needs rectifying if we are really to fully understand the capacity of this market to deliver and to monitor the outcomes achieved.

## Notes and references

1 Wilcox, S. and Williams, P. (unpublished) *Dreams and reality? Government, finance and the private housing market*. London: UK Finance.

2 At the time of writing it was unclear whether the £8 billion guarantee fund to support housebuilding (including SMEs) and purpose-built rented housing announced in the Autumn Budget 2017 might replace it.

3 See Barton, C. (2017) *Homeownership & renting: demographics*, Briefing Paper CBP 7706. London: House of Commons Library.

4 Corlett, A. and Judge, L. (2017) *Home Affront: housing across the generations*. London: Resolution Foundation.

5 See www.gov.uk/government/news/rogue-landlords-put-on-notice-as-government-announces-tough-new-powers for more details.

6 See for example Kent Reliance (2017) *Buy to Let Britain report*. Chatham: Kent Reliance; Clarke, A. and Oxley, M. (2017) *Using incentives to improve the private rented sector for people in poverty: an international review*. Cambridge: CCHPR, University of Cambridge.

7 RICS (2017) *Housing market soft patch to persist through next year, Housing Forecast, 2018*. London: RICS.

8 BPF (2017) *Unlocking the potential and benefits of Build to Rent*. London: British Property Federation with Savills and the LSE.

9 IPF (2017) *The Size and Structure of the UK Property Market: End-2016 Update*. London: IPF.

10 OBR (2017) *Housing Supply Forecast*, November 2017. London: OBR (see http://budgetresponsibility.org.uk/download/housing-supply-forecast-november-2017-economic-fiscal-outlook/).

11 Hamptons (2017) *Landlord competition with First Time Buyers*, unpublished note. London: Hamptons.

12 See Government Statistical Service (2012) *National Statistician's Review of Official Housing Market Statistics*. London: Office for Statistics Regulation; UK Statistics Authority (2017) *Systemic Review of Public Value; Statistics on Housing and Planning in the UK*. London: UKSA.