Chapter 3
Private housing

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As another decade passes it is worth remembering that a century ago in 1919 nine out of ten households rented their homes, whether whole dwellings or simply rooms. Now in 2019, the private rented sector (PRS) still provides homes to around one in five UK households. There are a variety of data sources (Census, Family Resources Survey, English Housing Survey, etc.) but the latest is the Labour Force Survey (July-September 2019).[1] This shows that in terms of households represented by persons aged 16-64, since 1996 the UK has seen a doubling in the proportion housed in the PRS.

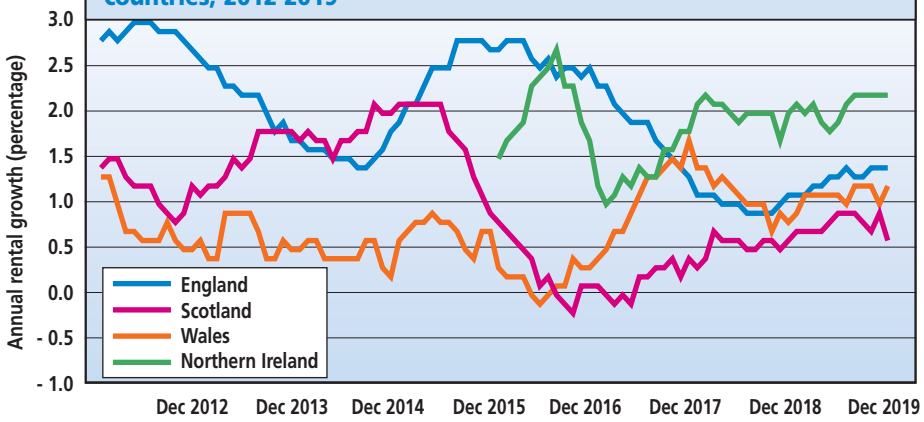
This growth may now have ceased given a modest recovery in homeownership and a tightening of policy around the PRS. Mortgaged homeownership remains the biggest tenure for working-age households (8.43 million) but the PRS now houses 4.44 million households, eclipsing social housing's 3.4 million and not far behind the 4.63 million outright owners. We should note that mortgaged homeownership peaked at ten million working-age households in October-December 2004. At that time the PRS housed 2.46 million households – mortgaged homeownership has subsequently shrunk by 1.57 million but the PRS has grown by nearly two million households. A recent Centre for Policy Studies report, *Resentful Renters*, argues that there are now 3.57 million renters who would have been owners, i.e. on this calculation a majority of those in the PRS.[2]

The tenure dynamics of the UK market have changed quite radically. At the heart of this are fundamental tensions around affordability which have acted to put downward pressure on homeownership and at the same time boost private renting, both on the demand side but also as an attractive option for private investors.

The private rented sector

Focussing on the latest trends in the PRS, we have to concede that knowledge and understanding of the sector is patchy, although it is improving through the efforts of the ONS, relevant government departments across the UK, trade bodies and others. The ONS Index of Private Housing Rental Prices (IPHRP) showed that rents (both newly let and existing) grew by 1.4 per cent in the 12 months to December 2019 in England, unchanged since October 2019 (and, if London is excluded, up by 1.6 per cent; see Compendium Table 53). Rents in Wales rose by 1.2 per cent in the same period, marginally up from November 2019, while Scottish rents rose by only 0.6 per cent in the 12 months to December 2019, a fall on the November 2019 data (on a number of indices Scottish rental growth is weakest, alongside a more stringent regulatory regime). The annual rate of change for Northern Ireland (2.2 per cent) in September 2019 is higher than the other UK countries. Over the longer term and as Figure 2.3.1 shows, rental growth has generally slowed over the last seven years even though it has strengthened a little in the last two. The England data are influenced by what the ONS calls 'strengthening growth in London.' As this suggests, there are very significant national, regional and local rent variations in the PRS market. Indeed many areas will have seen real-terms falls in rents.

Figure 2.3.1 **Percentage change in private rents over 12 months for UK countries, 2012-2019**



Source: ONS Index of Private Housing Rental Prices.

Differences between different rent indices

It is important to understand the differences between different rent indices. Private sector measures from organisations such as Homelet, LSL Property Services or Hamptons (formerly Countrywide) primarily focus on newly let properties, while the IPHRP includes both newly let properties and existing lets. This is important, as evidence suggests that the greatest price rises occur when properties are newly let, compared with existing tenants who tend to see smaller price increases. Zoopla in their new quarterly Rental Market report suggest rents are now rising at their fastest for three years with the annual rate of UK rental growth at 2.0 per cent, up from 1.3 per cent a year ago.

In terms of English regions, the London market has been notably volatile though the South West saw the biggest annual increase over this period, up 2.2 per cent. The RICS Residential Market Survey for December 2019 reported a decline in the volume of fresh rental stock coming onto the market, continuing the pattern that had been established over recent years. Their data indicated continued falls in landlord instructions in the month even though tenant demand remained steady. This suggests rents will rise in both the short and medium term with the RICS stating that 'Indeed, projections point to around 2 per cent rental growth over the coming year, while this is anticipated to accelerate to average closer to 3 per cent per annum over the next five years.'[3]

The growing rent pressures in part reflect the changes in tax and other policies affecting landlords and the PRS. An extensive Residential Landlords Association survey on the state of the sector was undertaken in the third quarter of 2019 covering nearly 2,000 landlords.[4] Unsurprisingly as members of the trade body, 83 per cent of the respondents owned more than one property (and therefore were untypical of landlords generally). Over 50 per cent were in southern England and 70 per cent were over 55 years of age. Over the last twelve months more of these landlords sold property (19 per ce≥nt) compared to buying (12 per cent) and the long-term trend in landlords reporting they will sell property is continuing upward with a third planning to either reduce their portfolio or exit the PRS market altogether. At the same time the proportion of landlords looking to expand has fallen to 12.2 per cent. In terms of rents, 65 per cent of these landlords were opting to freeze rents compared to raising rents (31 per cent) and next year, 50 per cent of landlords are planning to keep rent levels the same as this year. This is slightly at odds with the RICS agents survey cited above but clearly the sample base is quite different.

With landlords opting to buy fewer properties the number of homes available to rent has dropped, particularly in London and the South. And this lack of new supply has begun to drive rental growth. According to Hamptons 'there were 7.8 per cent fewer properties available to rent during the first 11 months of 2019 compared with the same period last year and in the South of England , where more landlords have sold up, there were 11.7 per cent fewer homes available to rent.'[5]

However, there are some indications that investors are starting to return to the market, particularly in London. Hamptons suggest that in the first 11 months of 2019 landlords bought 11 per cent of homes sold in Great Britain. This might reflect slowly rising rents and a stabilisation of property prices along with highly competitive buy to let mortgage finance.

Despite the negative policy environment and the overhang of Brexit uncertainty, after the general election a degree of confidence has returned to the market. It is possible this momentum will continue even though it is clear the new government intends to proceed with reforms to the laws in England governing the PRS (removing section 21 no fault evictions). Much will turn on how the proposed reforms are balanced out – if the government also puts in place a stronger enforcement regime and specialist housing courts, many landlords would view that positively, although anecdotal evidence from Scotland suggests that despite such improvements landlords still view the process as too slow.

With around 70 per cent of first-time buyers emanating from the PRS and with a significant number of households becoming landlords either accidentally or via choosing to retain and rent out their existing home while buying another to live in, the strong interconnections between the two tenures are apparent. Most landlords are homeowners and most owners have been tenants.

Alongside this mainstream PRS market (and the student rent market), there is also the emerging Build to Rent market. This has generated a considerable appetite among investment funds looking for stable long-term returns as well as meeting a demand for modern, quality rental homes in urban centres.[6] The British Property Federation reported that in excess of 10,000 new units were completed over the 12 months to the end of 2019. There are now over 150,000 units completed, under construction or in planning with roughly half in London and the rest elsewhere in the UK, but the latter are showing the higher growth rate with Manchester and Glasgow attracting attention.[7] Home Group has recently announced a new affordable and flexible Build to Rent programme in conjunction with institutional funding.[8]

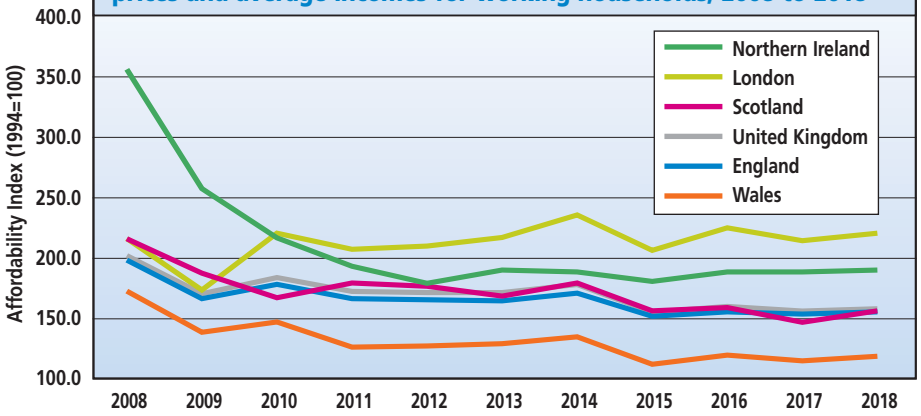
Affordability

Perhaps the most obvious tensions in this interconnected world are rent levels and the capacity to build a deposit and of course landlords competing with homebuyers to purchase cheaper homes. The rise in the number of young adults living with their parents is indicative of the tension. In 2019 some 3.5 million 20-34 year-olds were doing this, up nearly 50 per cent over the last two decades (numbers in part boosted by those in higher education) with many using the arrangement to build a deposit for buying a home. The combination of very few 100 per cent mortgage loans now available for first-time buyers, sharply inflated house prices in some areas – notably London and the South East of England – and the impact of the required stress test (described below) applied after the termination of any mortgage deal has meant that access to homeownership for those in pressured areas has been significantly constrained (unless they have a substantial deposit).

Little wonder then that the Bank of Mum and Dad (Bomad) supports around a third of buyers (an estimated £6 billion contribution in 2019) and that products such as Halifax's Family Boost mortgage have emerged. Donnell and Pannell explore the state of the mortgage market in some detail in a recent UK Finance report.[9] First-time buyer numbers have risen from the low base after the Global Financial Crisis and in late-2019 UK Finance statistics showed that from November 2018 up to and including October 2019 some 354,000 first-time buyer loans were made, making up about 50 per cent of total loans for home purchase. Of course, Help to Buy has boosted these numbers and this is discussed later (see also Commentary Chapter 6).

Table 45a in the Compendium is based on average first-time buyer house prices and average incomes for working households. It gives a view of long-term changes in affordability for this key group. Figure 2.3.2 shows affordability by country over the last decade, with Wales currently in the most favoured position and Northern Ireland the worst though all have seen major improvements since the crisis. London's affordability has moved out of line with the national averages over the last decade, no doubt reflecting the sustained squeeze on wages. It is likely to have improved in 2019/20 as will be seen once the data are available.

Figure 2.3.2 **UKHR Affordability Index based on first-time buyer house prices and average incomes for working households, 2008 to 2018**



Source: Compendium Table 45a.

Low interest rates and longer mortgage terms (around 40 per cent of FTBs have a term of 30 years or more) have of course eased some affordability constraints. There has been considerable debate around the impact of the Financial Policy Committee's two housing levers that bear down on the market.[10] Under these rules, lenders must check that borrowers are able to meet mortgage payments if mortgage rates moved three per cent higher in the first five years (the 'affordability test') and they must limit high-income multiple loans (those at or above 4.5) to no more than 15 per cent of new loans (the 'flow limit'). In its latest Financial Stability Report the Bank of England reviews its mortgage market recommendations and concludes they have prevented a 'loosening in underwriting standards' and have thus supported financial stability and by extension economic growth.[11] It recognises that the measures have impacted on some borrowers 'at the margin.'

The housing market

While the first-time buyer market has gathered a degree of momentum,[12] the remortgage market has now slowed and overall the impact of Brexit uncertainty, the election and a modestly performing economy has been to induce a degree of caution in the market. Homes now turn over, on average, once every 20 years compared to every eight years three decades ago and, as Donnell and Pannell argue,

there has been a 'structural decline in housing market liquidity'. For the UK as a whole, 2019 is likely to record around 1.1 million transactions (Land Registry data), slightly up on the average since 2005 along with Wales (since 1995) and Northern Ireland (since 2005). However, numbers in both England and Scotland were down on the average since 1995 in the former and 2004 in the latter. Mortgage approvals for house purchase (a forward indicator) were reasonably stable going into the year-end although there are early signs that markets have moved ahead since the general election.[13]

The buy to let (BtL) market has seen significant change as landlords adjust to the new tax regime that comes into force in 2020/21 – fewer homes have been bought so BtL mortgage lending for purchase is down. However, there has been significant remortgage activity (around three-quarters of total lending) as landlords adjust their borrowing to prepare for the ending of mortgage interest payments being deductible from rental income and the switch to lower tax credits. Moving to corporate structures to maximise tax advantages has not been as strong as anticipated although no doubt switching will continue. With stagnant prices at least in the more pressured markets, landlords who are buying have been focussed on lower-priced markets where rents can still produce a good yield and most of these purchases are via limited companies.

Government policies

Central to the modest boost in first-time buyer numbers is the Help to Buy scheme (examined in more detail in Commentary Chapter 6). This has been in place since 2013 and in England it runs to March 2021 (with a total commitment in the region of £22 billion to fund around 350,000 buyers). Then a somewhat more restrictive scheme comes into effect, focussed on first-time buyers and with regional price caps. These caps are set at 1.5 times the current forecast regional average price and will be quite limiting in terms of the scheme helping buyers to acquire a new home in some areas. This version is due to run till the end of March 2023.

The Help to Buy scheme in England has been subject to a number of evaluations.[14] These indicated that the scheme had been broadly helpful and met its objectives to a degree – assisting buyers and stimulating housebuilding (around 40 per cent of buyers could not have entered the market without it and newbuild output was up by around 15 per cent because of it). Nonetheless most of those who used the scheme could have bought anyway and it remains a contentious programme.

Scotland will end its scheme in 2021; Wales has yet to resolve its policy stance on the future of HtB and Northern Ireland does not have such a scheme. It is not clear whether in Scotland it will be replaced, but the Scottish Government has announced a First Home Fund: a £150 million shared-equity pilot scheme for first-time buyers only. It will offer non-interest-bearing equity loans of up to £25,000 to help buy a property, whether new build or an existing dwelling.

In England the government has also now announced a First Homes scheme where local authorities would use developers' contributions via the planning process to offer discounts of a third to local first-time buyers, and which would apply in perpetuity. Further details were given in a February 7th consultation paper. The government also set out its intention to improve access to shared ownership by allowing one per cent stakes – a proposal roundly criticised given the costs associated with such a purchase relative to the equity bought.

As this suggests, the new government is firmly committed to expanding homeownership in England and there is little sign that the wider all-tenures policy championed but not actually delivered by the previous regime will be retained despite the one nation rhetoric offered by the prime minister. Table 2.4.1 on page 68, which summarises all government support for housing investment in England, shows that around three-quarters of such support is still aimed at the private market (in contrast to the position in the other three UK countries, discussed in Commentary Chapter 4).

The fall-out from the devastating Grenfell fire has now impacted upon the homeownership market and in particular shared-ownership homes in high-rise blocks. Setting aside the private blocks where aluminium composite material is known to exist, the MHCLG building safety guidance on external wall systems issued in December 2018 is now impacting on the sales of homes in all blocks of 18 metres (typically six storeys) or more in height (there are around 11,500 such

buildings in all tenures). Valuers are taking the view that if there is no certificate to show that a building complies, then the flats within that block have nil value or at best one that is well below the original asking price. This in turn has meant that lenders have been unwilling to provide mortgages.

The G15 group of large housing associations in the South East has suggested that across their stock of such homes some 650 sellers have so far found that buyers cannot get a mortgage and a recent article suggested a perhaps rather high estimate of 600,000 people in England in unsellable flats.[15] Often detailed research of plans and specifications and/or physical examination is required, which is time consuming as well as being hindered by the limited availability of experts.

In many cases, leaseholders will be unaware of the issues until they try to sell or remortgage, with different surveyors and lenders taking different approaches. Most recently the RICS in conjunction with lender trade bodies have jointly published a one-page form that valuers can request from building owners that will require a professional with building expertise to confirm that the actual material on the walls is of limited or non-combustibility, or otherwise must spell out what work is needed. This facilitates valuations and lending decisions though they might still be negative. In addition, with homes in blocks below 18m in height, valuers will be expected to take a view on any fire safety issues that might impact on the valuation of a property (including cladding), but this will be a more limited assessment than in taller buildings. These issues, along with new concerns regarding timber-frame construction following the burning down of a block of shared-ownership homes in Worcester Park in London, have raised a lot of issues which might impede the push towards increased housing output. It has also exposed the tensions around leaseholder obligations to bear 100 per cent of the cost even though some may only own a small share of the home. This has also put more focus on the current Law Commission review of leasehold enfranchisement

Innovative homeownership finance

As noted, the new government in England has put the policy focus back on homeownership and it has set an aspiration to see lifetime, fixed-rate mortgages which might boost affordability for first-time buyers by allowing them to take out fixed-rate and higher LTV (loan-to-value) loans: up to 95 per cent and with no early-redemption charges. Though such models exist in other countries, e.g. Denmark, it has proved difficult to put them in place in the UK where consumers have favoured better-priced, shorter-term mortgage deals over longer-term loans with high redemption charges. This is especially the case in a historically low-interest-rate environment, with 3-5 year fixed-rate mortgages available at under two per cent: any new long-term, fixed-rate product will face intense competition. Nearly two decades ago the Miles Review (2004) set out recommendations for developing such a market but little progress has been made.[16]

However in recent months Perenna Capital Management have been promoting a new, flexible, 25-year, fixed-rate mortgage providing full payment certainty and protecting borrowers against interest-rate rises. The product would be funded via long-term life policies. It is one of a number that have emerged in the last year or so partly in response to a government consultation on innovative homeownership.[17] An array of schemes have been floated (e.g. private sector equity loans, equity-funded, top-up loans blended into the overall mortgage rate) but history tells us that, despite forays into interest-only and 95 per cent LTV loans, most UK homebuyers have been quite conservative. Many innovative schemes have failed to get traction either with borrowers or indeed lenders.

Despite the success of Help to Buy in terms of generating widespread take-up of an equity-loan scheme (notwithstanding its other weaknesses) and the continuing appeal of shared ownership, there are still gaps that remain to be filled. It is not clear yet that the UK government's rent-recognition challenge launched in 2017 (getting rent payment history as part of the credit record of would-be borrowers) has gained mass traction but with the rise of private renting, schemes which can help ease the transition between the two markets are clearly important.

Conclusions

As we move into the third decade of this century it is evident that significant changes have taken place in the private housing market: it is now very different from the market of the 1970s in which homeownership and social housing were dominant. Complex combinations of economic, social and demographic change

are being played out across countries, regions and localities in the UK, producing a very varied housing landscape. The May government's plan to champion social housing seems to have been curbed and a stronger focus on homeownership has re-emerged in England, although both Scotland and Wales have retained a more balanced policy approach. Fundamentally, governments and households are still wrestling with the accumulated affordability problems derived from decades of rampant house-price inflation relative to wages. The housing supply-based solution which is still being championed has been shown to have considerable limitations and it is now evident that more attention should be given to other factors such as taxation and access to credit.

After a decade of weak house-price growth and widening gaps in affordability by area[18] the market expectations for 2020 are for generally modest price inflation – around two per cent – and continuing low interest rates and intensive mortgage-market competition. While the buy to let market may have peaked the Build to Rent sector continues to demonstrate a degree of momentum. Much now turns on confidence, the health of the economy and in-migration. Certainly the long-established preference for homeownership is now much more qualified and caveated even though the economics continue to point to this tenure as a rational choice for many.[19]

Notes and references

1 The latest English Housing Survey shows household tenure patterns are currently static in England (2018/19) but that the proportion of 25-34 year-olds in homeownership has increased, as has the proportion of 55-64 year-olds living in the PRS.

2 Edwards, G. (2019) *Resentful Renters: How Britain's housing market went wrong, and what we can do to fix it*. London: Centre for Policy Studies.

3 RICS (2020) *Outlook for activity strengthens after election result*, UK Residential Market Survey, December 2019. London: RICS.

4 See https://research.rla.org.uk/research-reports/state-of-the-prs-quarter-3/

5 Hamptons (2019) *Rental growth accelerates in 2019*, Monthly Lettings Index, November. London: Hamptons.

6 Scanlon, K. *et al* (2018) *Build to Rent in London: A report by the University of New South Wales for NSW Landcom*. London: LSE.

7 British Property Federation (2020) *Number of newly completed build-to-rent homes across UK regions increases by 51 per cent in 2019*, BPF press release, 17 January 2020 (see www.bpf.org.uk/media-listing/press-releases/number-newly-completed-build-rent-homes-across-uk-regions-increases-51).

8 See www.homegroup.org.uk/Media/News/Home-Group-news/New-UK-housing-fund-to-ramp-up-delivery-of-affordable-homes

9 Donnell, R. and Pannell, B. (2019) *The Changing Shape of the UK Mortgage Market: Emerging Themes*. A joint report from UK Finance and Hometrack (part of Zoopla), December. London: UK Finance.

10 See for example Thomas, R. (2019) *The intergenerational divide in the housing and mortgage markets*. London: Intermediary Mortgage Lenders Association.

11 These recommendations are made to the FCA and PRA to enforce. See Bank of England (2019) *Financial Stability Report*. London: BoE, November.

12 Halifax estimates numbers of FTBs in 2019 at 356,767, up one per cent on 2018. See Halifax (2020) *First-time buyers' costs soar over last year*, Press Release, 25 January 2020.

13 RICS (2020) *Outlook for activity strengthens after election result*, RICS Residential Market Survey, December. London: RICS; Nationwide BS (2020) *Modest pick-up in house price growth in January*, Press Release, January.

14 See for example Finlay, S. *et al* (2016) *Evaluation of the Help to Buy Equity Loan Scheme*. London: MHCLG; Whitehead, C. *et al* (2018) *Evaluation of the Help to Buy Equity Loan Scheme 2017*. London: MHCLG; National Audit Office (2019) *Help to Buy: Equity Loan scheme – progress review*, HC 2216 session 2017-2019. London; NAO.

15 Jones, R. (2019) 'Mortgage prisoner: I've been told I can't sell for years', in *The Guardian*, 28 December.

16 Miles, D. (2004) *The UK Mortgage Market: Taking a Longer-Term View*. London: HMSO.

17 See www.gov.uk/government/consultations/private-shared-homeownership-call-for-proposals

18 Nationwide BS (2020) *House prices and affordability through the decades*, Special Report, January. Swindon: Nationwide.

19 Preece, J. *et al* (2020) 'Understanding changing housing aspirations: a review of the evidence', in *Housing Studies*, 36(1), 87-106.