



**Response to Treasury Consultation on the  
Private Rented Sector**

**Submission by PricedOut**

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# Contents

Introduction and Summary .....	4
Chapter 1 The Impact of Buy-to-Let on the UK Housing Market .....	8
1.1 The Role of Increased Demand in Higher UK House Prices .....	8
1.2 The Impact of Increasing Buy-to-Let Demand on Higher UK House Prices.....	9
1.3 The Negative Social and Economic Impact of Higher House Prices .....	14
Chapter 2 The Financial Impact of Buy-to-Let Investment .....	15
2.1 Buy-to-Let and Financial Volatility .....	15
2.2 Buy-to-Let and Speculative Investment .....	15
2.3 Buy-to-Let and Investor Financial Vulnerability.....	16
2.4 Buy-to-Let, Wider Financial Stability and Costs to the UK Economy .....	17
Chapter 3 Buy-to-Let and its Negative Impact on First Time Buyers.....	21
3.1 Buy-to-Let and First Time Buyers .....	21
3.2 Buy-to-Let, Financial Products and Purchasing Power.....	22
3.3 Buy-to-Let and Tax Advantages over First Time Buyers .....	23
Chapter 4 Institutional Investment and the UK residential property market .....	26
4.1 Institutional Investment and Increased Demand in the UK Housing Market .....	26
4.2 Institutional Investment and Volatility.....	26
4.3 Wider Policy Implications for the UK Housing Market.....	27
Chapter 5 Buy-to-Let, Housing and Wealth Distribution .....	29
5.1 Housing and Growing UK Wealth Inequality.....	29
5.2 The Distributional Impacts of the Private Rented Sector .....	30
Chapter 6 Housing Supply, Buy-to-Let and the Impact on Owner Occupation .....	32
6.1 Buy-to-Let and UK Housing Supply .....	32
6.2 BTL Impact on Supply in the Owner Occupation Sector.....	33
6.3 Buy-to-Let – Providing the Wrong Supply Incentives?.....	34
Chapter 7 Tenants' Rights .....	36
7.1 Buy-to-Let and UK Tenants' Rights .....	36
7.2 European Comparisons of Tenants' Rights .....	36
7.3 Security of Tenure and Sustainability of PRS Investment.....	36

## Introduction and Summary

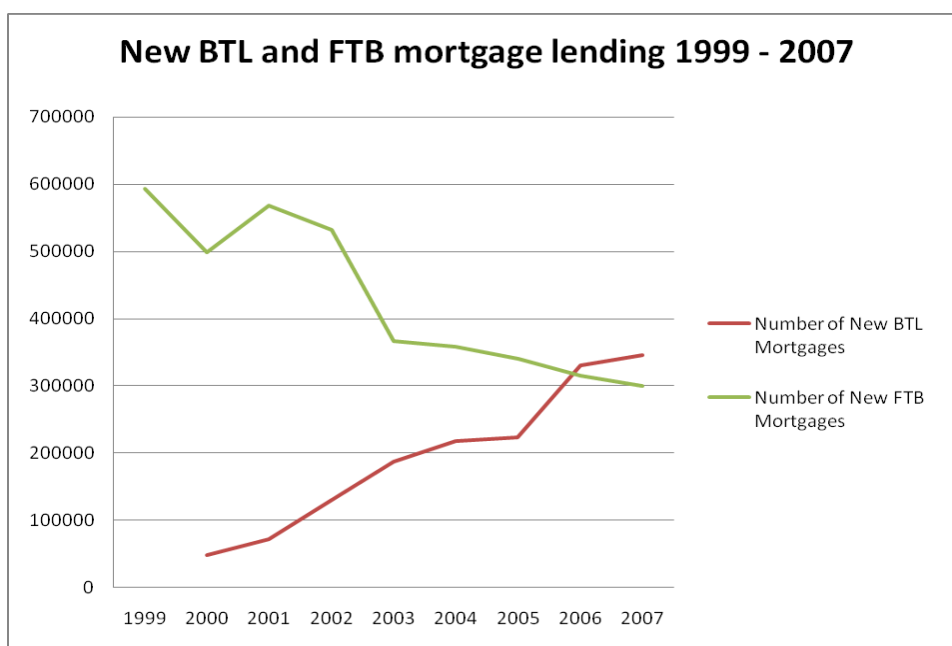
PricedOut is a group representing the interests of First Time Buyers (FTBs) who are currently unable to afford housing in the UK. PricedOut aims to raise awareness of the damage being caused by unaffordable house prices through its website, its campaign activities and active canvassing of policy makers and the media.<sup>1</sup> PricedOut was founded in February 2006 and is staffed entirely by volunteers. We have more than two thousand registered members.

Whilst there are a number of organisations, charities and campaigns dealing with the important issues of social housing and homelessness there is no group representing First Time Buyers who are being negatively affected by unaffordable house prices.

We welcome the opportunity to comment on this consultation of the future of the Private Rented Sector (PRS), however are concerned by the deep weaknesses displayed in this consultation document.

PricedOut has **six key causes for concern** for First Time Buyers:

1. **The Treasury paper shows a weak understanding of the dynamics of the UK housing market and fails to address the impact of increased demand created by the exponential growth of the Buy-to-Let (BTL) sector on UK house prices and the negative impacts this has for First Time Buyers and the UK economy.**



Source: CML BTL mortgage lending data, Halifax First Time Buyer Review 2007

The number of Buy-to-Let mortgages increased tenfold from just 3.5% of house purchase mortgages in 1999 to 28.9% in 2006.<sup>2</sup> This represents over 1 million new Buy-to-Let mortgages. Additionally, it is estimated that only 54%<sup>3</sup> of Buy-to-Let landlords use Buy-to-Let mortgage finance to purchase their

<sup>1</sup> See <http://www.pricedout.org.uk/>

<sup>2</sup> Council for Mortgage Lenders data

<sup>3</sup> See Ball, M. (2006) Buy-to-Let: The Revolution Ten Years On – Assessment and Prospects, Association of Residential Letting Agents (ARLA)

properties, meaning that, in reality, the number of UK Buy-to-Let properties is significantly higher. Conservative estimates calculate that this additional demand has added at least an extra 7.4% to UK house prices, equivalent to £13,485 on the average British Home.<sup>4</sup> This dwarfs the average amount spent by FTBs on stamp duty - £1,750 according to Halifax.<sup>5</sup>

High house prices, driven in part by the rise in Buy-to-Let, have displaced an estimated 1.2 million 'new' households away from Owner Occupation<sup>6</sup> and have led to around 1.4m fewer First-Time Buyer mortgages since 1999.<sup>7</sup> A recent report by the Council for Mortgage Lenders (CML) found that levels of Owner Occupation are at their lowest since the 1980s.<sup>8</sup>

High housing costs also contribute a damaging drag on UK economic performance. They increase personal debt levels, concentrate individual wealth portfolios disproportionately in one asset class and increase vulnerability to external credit shocks. High house prices reduce labour mobility, add an additional cost to UK businesses in higher wages and drain disposable income out of the wider economy. The misallocation of resources impacts on the total level of investment capital available for businesses and wider consumption levels.

**2. The Treasury Paper fails to address the negative impact of the speculative and volatile nature of the Private Rental Sector investment, which creates instability in the UK housing market and the wider economy.**

Buy-to-Let activity has been highly volatile. The number of outstanding BTL mortgages increased ten-fold from mid 2000 to 2007. It then halved in 2008 and halved again in 2009. The main Buy-to-Let lenders in the UK were at the forefront of using new financing mechanisms, such as the use of wholesale funding markets and Mortgage Backed Securities issuance, which enabled the credit boom and left the UK particularly vulnerable to the credit crunch. Repossessions of Buy-to-Let properties are also higher than in the UK residential mortgage market – substantially so, well over twice the rate, when the 'Receiver of Rent' mechanism available to creditors is taken into account.<sup>9</sup>

As a result, eight of the top nine UK Buy-to-Let lenders in 2007 have now either been rescued by the tax payer after threatened bankruptcy, are closed for further business or have been badly damaged by the financial crisis and are undergoing substantial retrenchment.

**3. The Treasury Paper fails to acknowledge or address the highly uneven playing field created for PRS investors in the UK residential property market. Buy-to-Let investors are able to use financial products that give them greater purchasing power and exploit generous tax breaks to out bid First Time Buyers for UK property.**

Unequal purchasing power due to the UK tax system and lax financial regulation has given Buy-to-Let investors an unfair advantage over First Time Buyers and lies behind the growing displacement of First time Buyers with property investors.

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<sup>4</sup> See 'Buy to Let mortgage lending and the impact on UK house prices: a technical report', Ricky Taylor, National Housing and Planning Advice Unit, Department of Communities & Local Government.

<sup>5</sup> Halifax First Time Buyer Review, December 2007

<sup>6</sup> 'Affordability – more than just a housing problem', NHPAU, May 2009

<sup>7</sup> <http://www.telegraph.co.uk/finance/newsbysector/constructionandproperty/2821472/First-time-buyers-set-to-rescue-house-prices.html>

<sup>8</sup> Council of Mortgage Lenders, <http://news.bbc.co.uk/1/hi/business/8547902.stm>

<sup>9</sup> Council for Mortgage Lenders, 'Buy to Let lending in 2009' <http://www.cml.org.uk/cml/media/press/2540>

Council for Mortgage Lenders data analysed by PricedOut shows that, for an average First Time Buyer property, BTL investors' mortgage costs – given their tax advantages and use of interest only mortgages – amount to just over a seventh of their net income, whereas FTB average mortgage costs amount to a nearly a third of net income. PricedOut are calling on the government to change the tax system to stop this unfair advantage and allow First Time Buyers a chance to get on the housing ladder.

**4. Contrary to stated UK government policy objectives, the UK Private Rented Sector has decreased the supply of UK housing available for Owner Occupation.**

Rather than increasing the supply of UK housing, Buy-to-Let investment has created a net loss in the supply of houses available to UK First Time Buyers and Owner Occupiers. In the last six years, the net loss of total supply, including new build market housing, from Owner Occupation to BTL mortgage purchasers was 647,300 dwellings. Despite substantial levels of private sector house building, BTL purchases has led to the total stock of Owner Occupation houses declining by nearly two thirds of a million homes. Rather than building new homes, since 2003 government housing policy has effectively removed at least 647,300 British homes that First Time Buyers can buy – flying in the face of government rhetoric to be helping First Time Buyers.

**5. The Treasury paper fails to take into account the negative social impact of Private Rented Sector investment in the UK housing market, including rising house prices. Additionally, it fails to acknowledge its impact on inequalities in wealth distribution**

High house prices, exacerbated by rising levels of Private Rented Sector investment in the UK housing market, have contributed to wide-reaching negative social impacts. Waiting lists for social housing are currently at a record high of 4.5 million people. A recent study by Shelter found that 1.5 million adults say that they are unable to look after their elderly parents because they can't afford to live near them, whilst 21% of 18-44 year olds, equivalent to 2.8 million people, are actively delaying having children because of high housing costs<sup>10</sup>.

Inequalities in housing wealth are now highly pronounced and growing. According to new data, the aggregate value of housing wealth held by those aged 50 to pension age (representing 7.1 million people)- was £1,280bn, more than twice the housing wealth held by any other age group. The next wealthiest group is those between pension age and 75 (5 million people), whose housing wealth was £600bn. This is despite these groups being smaller in population terms than the 35-44 age group<sup>11</sup>. Yet the Treasury paper completely fails to acknowledge the wealth distributional impact of the Private Rented Sector, both through its macro level on increasing house prices and in the rents PRS investors secure over tenants- many of whom are priced out First Time Buyers.

**6. The Treasury paper over-estimates, and fails to scrutinise, the demand for private rented accommodation in the UK, the majority of which is created by priced out First Time Buyers. Additionally, the paper fails to acknowledge or explore the relationship between greater levels of tenant security and the larger and more stable Private Rented Sector that exists in many European countries.**

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<sup>10</sup> Shelter Research from February 8<sup>th</sup> 2010 and 18<sup>th</sup> January 2010  
[http://england.shelter.org.uk/news/february\\_2010/affordability\\_crisis\\_fractures\\_families](http://england.shelter.org.uk/news/february_2010/affordability_crisis_fractures_families) and  
[http://england.shelter.org.uk/news/january\\_2010/housing\\_costs\\_forcing\\_delay\\_in\\_having\\_children](http://england.shelter.org.uk/news/january_2010/housing_costs_forcing_delay_in_having_children)

<sup>11</sup> ONS, 'Wealth in Britain' survey, 2010. [http://www.statistics.gov.uk/downloads/theme\\_economy/wealth-assets-2006-2008/Wealth\\_in\\_GB\\_2006\\_2008.pdf](http://www.statistics.gov.uk/downloads/theme_economy/wealth-assets-2006-2008/Wealth_in_GB_2006_2008.pdf)

PricedOut challenges a key assumption of the Treasury paper, which states that the PRS meets the demand for rented properties in the UK. Whilst there is some demand for flexible, rented accommodation, a recent study by the Royal Institute of Chartered Surveyors found that only 13% of those who rent in the UK do so by choice. Instead, many would-be Owner-Occupiers are being displaced by Buy-to-Let investors. Sustainable, affordable housing is more important to priced out renters than flexibility.

UK renters face significantly weaker tenants' rights than their European counterparts. PricedOut is concerned that, although the remit of this Treasury paper is the Private Rented Sector, it fails to address the rights of UK tenants. It also demonstrates a bias towards further reducing tenant's rights as the key to growing the Private Rented Sector, a position which the European experience of greater tenants rights combined with larger and more stable Private Rented Sectors than the UK offers little support.

These failures are depressing - HM Treasury is meant to rigorously represent the broad and long term interests of the UK economy. Yet the terms and framework of this consultation paper are extremely narrow and conceptually flimsy.

The failure to recognise or explore the additional price pressures, risk and volatility that the PRS sector has added to FTBs housing choices, the UK housing market and the UK economy is worrying. The mooted proposals, notably to further extend the tax breaks available to the PRS sector over First Time Buyers and to seek to encourage additional speculative PRS investment flows into the UK residential housing market, are highly alarming.

HM Treasury and the UK government should start to ask much tougher questions about the direction this consultation paper sets out and take a much more critical assessment of the wider economic and social costs of the PRS sector.

PricedOut is campaigning for the following **four changes to UK government policy**:

- The current unfair tax advantages BTL investors have over First Time Buyers should be removed. For existing residential property, BTL investors should not be able to write interest payments off against tax. These tax breaks should only be available for new build property built specifically for BTL investors and a new category of private rented housing.
- The Financial Services Authority should oversee BTL mortgage regulation and implement much tighter oversight of BTL mortgage borrowers and lenders. A central element of this regime should be to outlaw the use of interest only mortgages without a parallel and financially robust repayment vehicle for the capital value of the house.
- The Government should seek to discourage investment into the PRS sector that is primarily based on expectations of capital gains. The Government should reverse its previous cuts to capital gains tax to a level consistent with current income tax rates and introduce a substantially higher capital gains tax rate on investment property owned for less than ten years. The government also should clamp down on widespread capital gains tax avoidance.
- The Government should improve tenants' rights to levels comparable to the rights of tenants in the European countries cited in this paper (table 5). PricedOut recommends an incremental system such as the model that exists in the Republic of Ireland, whereby tenants' rights increase proportionally to reflect the amount of time that a tenant has lived in a property. Such a change would keep the flexibility of the Private Rented Sector where a short let is required, but increase the sustainability and security of housing for tenants.

# Chapter 1 The Impact of Buy-to-Let on the UK Housing Market

## 1.1 The Role of Increased Demand in Higher UK House Prices

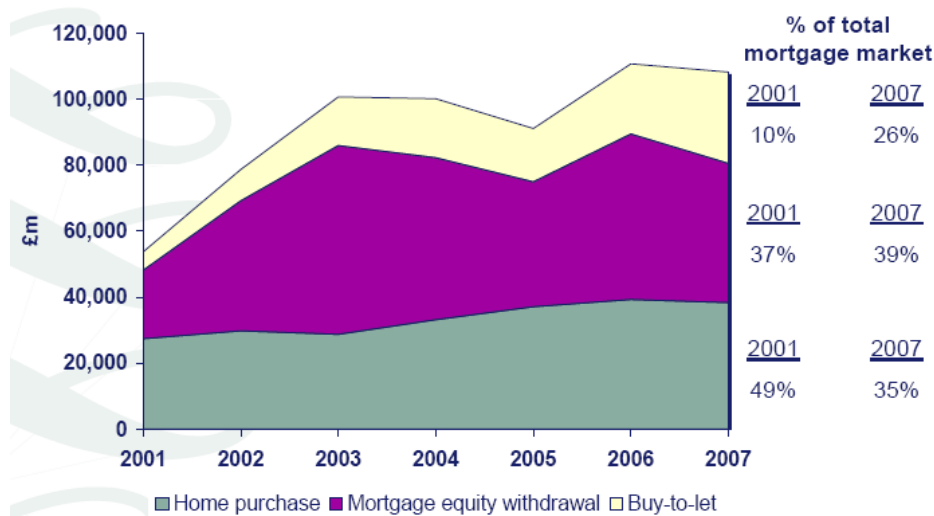
The UK housing market is far from a perfect market. It suffers from a supply base that is extremely restricted and sluggish in its responsiveness to changes in demand. It has volatile levels of demand and has a strong cyclical nature – notably driven by price expectations, the business cycle and levels of credit availability (see for example Andrew Farlow)<sup>12</sup>.

To quote the economist David Miles, UK housing supply is “all but fixed in short run”. Britain’s total housing supply grows extremely slowly, at less than 1% of the total stock per year, and bears a weak relationship to total levels of demand.

The result of this irresponsible supply side is that sudden changes in demand are mainly reflected through price changes rather than extra supply.

The PRS has undoubtedly been a very important new component of total UK housing demand, yet the consultation document totally fails to explore what the implications of this are for the market – both in terms of prices and levels of volatility.

**Graph 1 – UK Mortgage Lending by Purpose 2001 - 2007**



Source: FSA, Bank of England, CML, taken from ‘The Mortgage Market: Issues for Debate’, Adair Turner Chairman FSA Mortgage Conference 12 May 2009

<sup>12</sup> Andrew Farlow, Oriel College, Oxford ‘UK House Prices, Consumption and GDP in a Global Context’ <http://www.economics.ox.ac.uk/members/andrew.farlow/Farlow%20Housing%20and%20Consumption.pdf>

## **1.2 The Impact of Increasing Buy-to-Let Demand on Higher UK House Prices**

The raised availability of mortgage finance is known to stimulate the demand for housing (Pain and Westaway, 1996).<sup>13</sup>

The growth of mortgage finance for BTL has been impressively large. As the consultation paper notes, the number of outstanding BTL mortgages increased ten-fold from mid-2000 to reach over one million by 2007, with a total value of over £122 billion. It has been *the* outstanding area of growth in total mortgage financing for UK house purchases (see graph 1 above).

Official BTL financing is almost certainly an understatement of the total level of BTL finance in the UK residential market – given the widespread use of mainstream mortgage finance to fund investment and the large numbers of cash purchases involved. Michael Ball of Reading University estimates that only 54% of BTL landlords use mortgage finance for purchasing their properties.<sup>14</sup> In addition research based on interviews with landlords has confirmed that BTL mortgages are used by around 50% of landlords but are not the only funding mechanism (Stoke-on-Trent CC 2006, unpublished research for Gateway and West Yorks Housing Partnership).<sup>15</sup><sup>16</sup>

**Question: ‘There is a very large gap in our knowledge of the size and structure of the new PRS sector. What is the government proposing to properly track the number of PRS landlords and properties?’**

But even just using the narrow definition of BTL mortgage financing, BTL has grown in the space of just six years from a marginal niche sector to a very large part of the UK housing market. For a market as mature as the UK housing market these trends are very striking.

As table 1 demonstrates, BTL mortgages rose from just 3.5% to 28.9% of total house purchase mortgages in the UK between 1999 and 2006.

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<sup>13</sup> Pain, N. and Westaway, P. (1996). Modelling structural change in the UK housing market: A comparison of alternative house price models. National Institute of Economic and Social Research and Bank of England. <http://www.niesr.ac.uk/pubs/dps/dp98.pdf>

<sup>14</sup> See Ball, M. (2006) Buy-to-Let: The Revolution Ten Years On – Assessment and Prospects, Association of Residential Letting Agents (ARLA), available at: [http://digitalnation.fileburst.com/arla/arla\\_btl\\_report\\_2006.pdf](http://digitalnation.fileburst.com/arla/arla_btl_report_2006.pdf)

<sup>15</sup> Stoke-on-Trent City Council (2006) Private Rented Sector Study. On line ([www.stoke.gov.uk/ccm/content/hcp/housing\\_misc/private-rented-sectorresearch-en](http://www.stoke.gov.uk/ccm/content/hcp/housing_misc/private-rented-sectorresearch-en))

<sup>16</sup> Cited in Buy-to-let and the wider housing market, Nigel Sprigings, University of Glasgow, People, Place & Policy Online (2008): 2/2, pp. 76-87

**Table 1 – Buy-to-Let Mortgages and House Purchase Mortgages 1999-2006**

	Total number of Mortgages for House Purchase	Total number of BTL mortgages	BTL mortgages as a % of total house purchase mortgages	Growth in proportion of BTL mortgages from previous year
1999	1,253,900	44,400	3.5%	
2000	1,123,300	48,400	4.3%	0.8%
2001	1,313,700	72,200	5.5%	1.2%
2002	1,396,900	130,000	9.3%	3.8%
2003	1,251,800	187,600	15%	5.7%
2004	1,242,600	217,700	17.5%	2.5%
2005	1,016,400	223,800	22%	4.5%
2006	1,141,000	330,300	28.9%	6.9%

Source: CML Tables ML1 and MM6: CML website

And as table 2 demonstrates, BTL mortgages as a percentage of total housing transactions grew from 3% in 1999 to approaching 20% of transactions in 2006.

**Table 2 – Buy-to-Let Mortgages as a Proportion of Transactions 1999 - 2006**

	Total Transactions	BTL Mortgages as a % of transactions
1999	1,469,000	3%
2000	1,433,000	3.4%
2001	1,458,000	4.9%
2002	1,586,000	8%
2003	1,344,000	14%
2004	1,787,000	12%
2005	1,531,000	14.6%
2006	1,774,000	18.6%

Source: CLG Live Table 532 and CML Table MM6

Even using the narrow definition of BTL and investor activity, it is clear it that this growth in demand is of a scale that has the potential to drive up prices in a market with comparatively fixed supply.

Any source of funding that has grown in six years from negligible levels to account for nearly 30% of house purchase lending and nearly 20% of housing transactions has the potential to have a “price driver” impact. Given the scale of price rises in the same period it is reasonable to assume that the role of the BTL sector in price rises has been significant.

*“Residential property markets have been penetrated to significant levels by investment money unrelated to occupancy of the target stock. This has occurred to such an extent that it is no longer primarily household consumer activity that drives the market.”*

*Nigel Sprigings, University of Glasgow<sup>17</sup>*

A research paper by the National Housing and Planning Advice Unit (NHPAU) commissioned by the Department for Communities and Local Government found that “there are good reasons to assume that the rapid growth in BTL investment has increased house prices. The record levels of investment could have raised demand and with supply more or less fixed in the short-term, this would help to push up prices.”

<sup>17</sup> Buy-to-let and the wider housing market, Nigel Sprigings, University of Glasgow, People, Place & Policy Online (2008): 2/2, pp. 76-87

The study concluded that BTL lending may have increased the average UK house price by 7.4% by 2007.<sup>18</sup>

This was the equivalent of an additional £13,485 on UK house prices ["BTL lending had increased prices by £13,485 (or 7.4%) over and above what they would otherwise have been"]. This dwarfs the average amount spent by FTBs on stamp duty - £1,750 according to Halifax.<sup>19</sup>

Another study on the UK housing market from the independent research consultancy Oxford Economics found BTL purchasers "undoubtedly contributing to the overvaluation of housing".<sup>20</sup>

These national studies are backed by several local studies. One local level study of Glasgow found that one in three landlords explicitly attributed the rental market investment to contributing to higher house prices (Gibb and Nygaard, 2005)<sup>21</sup>. A second local level study also included anecdotal evidence that the buoyancy of the private rented sector of Burngreave in Sheffield had contributed to house price inflation (Hickman et al, 2007).<sup>22</sup>

Unsworth (2007)<sup>23</sup>, for example, found that the city centre market in Leeds between 2001 and 2004 was driven by speculative investors looking for short-term capital gain. Most apartments were bought off-plan with little regard for the quality of the product or the location. This type of investment is also reported in studies elsewhere in Yorkshire and Humber (Hickman et al, 2007)<sup>24</sup>, in Stoke-on-Trent (ECOTEC and SURF, 2006)<sup>25</sup>, Manchester and Sheffield (Allen and Blandy, 2004)<sup>26</sup> and Glasgow (Gibb and Nygaard, 2005)<sup>27</sup>.

**Question: 'Why has the consultation paper not cited any of these papers and the evidence they give of the impact of Buy-to-Let on increased house prices?'**

There are a variety of economic models that try to explain the large growth in house prices in the UK over the past ten years. Many are based primarily on assuming the changes are to be explained by an imbalance between housing supply and demand from a growing number of households. However recent experience and other evidence should lead us to be more critical of these assumptions.

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<sup>18</sup> See '*Buy-to-let mortgage lending and the impact on UK house prices: a technical report*' Ricky Taylor, National Housing and Planning Advice Unit, the Department of Communities and Local Government Website <http://www.communities.gov.uk/documents/507390/pdf/684943.pdf>

<sup>19</sup> Halifax First Time Buyer Review, December 2007

<sup>20</sup> See <http://www.guardian.co.uk/business/2007/aug/06/housingmarket.houseprices>

<sup>21</sup> Gibb, K and Nygaard, C (2005) 'The impact of buy to let residential investment on local housing markets: Evidence from Glasgow, Scotland' European Journal of Housing Policy 5.3 pp301-26.

<sup>22</sup> See '*Buy-to-let mortgage lending and the impact on UK house prices: a technical report*' Ricky Taylor, National Housing and Planning Advice Unit, the Department of Communities and Local Government Website <http://www.communities.gov.uk/documents/507390/pdf/684943.pdf>

<sup>23</sup> Unsworth R (2007) City living in Leeds 2007 KW Linfoot, Morgans City Living and the University of Leeds: Leeds

<sup>24</sup> Hickman P, Robinson D, Casey R, Green S and Powell R (2007) Understanding housing demand: Learning from rising markets in Yorkshire and the Humber Chartered Institute of Housing/Joseph Rowntree Foundation: Coventry/York

<sup>25</sup> ECOTEC and SURF, University of Salford (2006) Dynamics of the private rented sector in Stoke on-Trent ECOTEC: Birmingham

<sup>26</sup> Allen C and Blandy S (2004) The future of city centre living: Implications for urban policy CRESR, Sheffield Hallam University: Sheffield

<sup>27</sup> Ibid

The first is the difference between the substantial growth in UK house prices and the static and falling levels of UK market rent levels. If demand from increasing households was the main cause of house price rises this is difficult to reconcile with falling levels of rents.

The second is the long history of cyclical behaviour in the UK housing market and the clear effect that factors such as credit availability, growth in effective demand and expectations have on the pricing of UK housing.

Economist and MPC member David Miles in a study for Morgan Stanley found that expectations of capital gains, rather than supply and demand fundamentals, accounted for nearly 40% of UK house price growth between 1998 and 2008.<sup>28</sup>

As the consultation paper observes, and we explore below, BTL investment since 2004 has, due to very low and negative yields, *been almost solely reliant on an assumption of future capital gain – i.e. expectations of price rises.*

BTL as an investment class has the sole rationale of financial gain, rather than the dual use of Owner Occupation where price is balanced against occupier use. It is reasonable to assume therefore that the BTL sector has been an important mechanism through which expectations of price rises have been transmitted and amplified into the UK housing market.

BTL investment has also benefited from the large growth in credit availability and liquidity in the UK mortgage market before 2007. The main UK BTL lenders were also at the forefront of using new financing mechanisms, such as the use of wholesale funding markets and Mortgage Backed Securities issuance, which enabled this credit boom – and left the UK particularly vulnerable to the credit crunch.

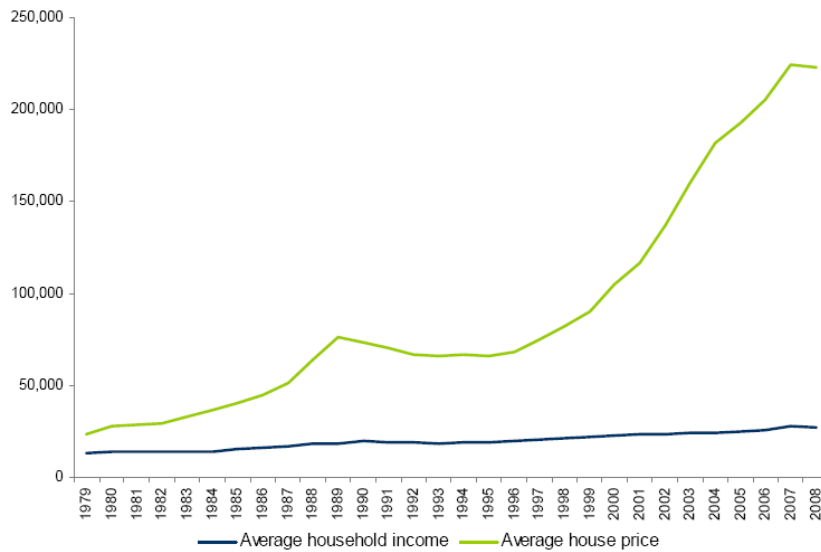
Again, it is reasonable to assume that the growth in the BTL sector has been an important mechanism through which excessive credit availability has been transmitted and amplified into the UK housing market – and led to higher UK house prices.

There certainly seems to be a strong correlation between the period of very high growth in BTL lending from 2001 to 2007 and the period of very high growth in UK house prices. The relative novelty of BTL lending is also striking when looking at how UK house prices appear to have departed substantially from long term historical price to income ratios in this matching period (graphs 2 & 3).

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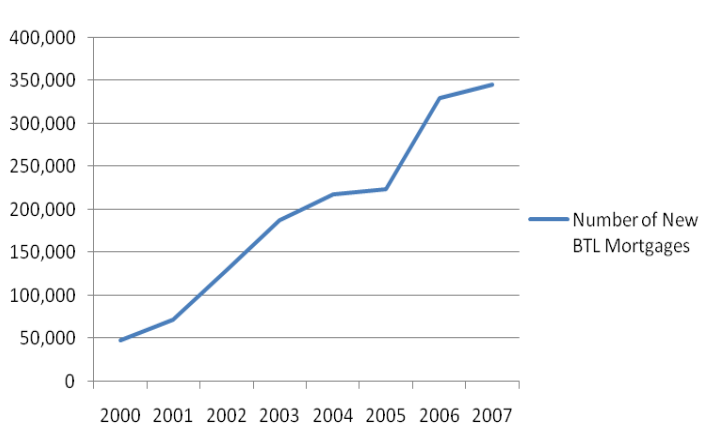
<sup>28</sup> See 'How will housing and mortgage markets emerge from the credit crunch?' David Miles, June 2008, Morgan Stanley investor presentation at <http://www.niesr.ac.uk/event/wef%202008%20seminar%203%20-%20how%20will%20housing%20and%20mortgage%20markets%20emerge%20from%20the%20credit%20crunch%2023.06.2008/d%20miles%20wef%203.ppt>.

**Graph 2 – UK Average Income and Average House Price 1979 - 2008**



Source: Taken from 'Time to Stop Betting the House: Mortgages, Resilience and the Long Finance', David Steven, 2010

**Graph 3 – Number of New Buy-to-Let Mortgages 2000 - 2007**



Source: Council for Mortgage Lenders

**Question: 'Does the UK government see a relationship between higher residential house prices and the PRS sector?'**

**Question: 'Is the UK government concerned that the PRS sector's contribution to higher residential house prices acts against government policy aimed at improving housing affordability and leads to negative wider economic and social outcomes? What steps could it take to address this?'**

## 1.3 *The Negative Social and Economic Impact of Higher House Prices*

*“The high price of fuel is causing understandable outrage across the country. Transport is, after all, fundamental to our lives. Yet housing is still more important. Moreover, across the UK as a whole, the real price of housing has more than doubled over the past decade. Yet this socially destructive development is, for many, an occasion for self-congratulation. ... Putting the price of housing beyond the means of a large proportion of young people is not merely economically inefficient but socially destructive.”*

*Martin Wolf, Financial Times*<sup>29</sup>

### • **The Social Costs of High House Prices**

Improving housing affordability and housing conditions are very important strands of government social and economic policy. Yet the past ten years have seen signal failures in several stated government objectives – driven significantly by high house prices.

Housing affordability has worsened considerably, with First Time Buyers now at all time lows. High house prices create more pressure on the social housing market and reduce the amount of housing goods available for people across all income groups. This has led to significant worsening in waiting lists for social housing (a record 4.5 million people in England are on housing waiting lists<sup>30</sup>) and led to overcrowding and housing pressure through the market – particularly for lower income groups and younger age groups.

The range of negative social impacts is wide reaching. To take just two examples, according to the housing charity Shelter, 1.5 million adults say they are unable to look after their elderly parents because they can't afford to live near them whilst 21% of 18–44 year olds, equivalent to 2.8 million people nationwide, are actively putting off having children because of high housing costs.<sup>31</sup>

### • **The long term economic costs of high UK house prices**

Increasing house prices do not represent increased levels of wealth, but rather redistribute the future earnings of new buyers into the increased asset values of current owners.

High housing costs also contribute a damaging drag on UK economic performance. They increase personal debt levels, concentrate individual wealth portfolios disproportionately in one asset class and increase vulnerability to external credit shocks. High house prices reduce labour mobility, add an additional cost to UK businesses in higher wages and drain disposable income out of the wider economy. The misallocation of resources impacts on the total level of investment capital available for businesses and wider consumption levels. As Martin Wolf observes, economically, “it is mad to applaud ever-rising prices”<sup>32</sup>

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<sup>29</sup> Financial Times, September 22 2005, <http://www.ft.com/cms/s/1/b7c6d4c4-2b95-11da-995a-00000e2511c8.html>

<sup>30</sup> NHF press release, 8 February 2010

<sup>31</sup> See Shelter research from 1<sup>st</sup> February and 18<sup>th</sup> January 2010, [http://england.shelter.org.uk/news/february\\_2010/affordability\\_crisis\\_fractures\\_families](http://england.shelter.org.uk/news/february_2010/affordability_crisis_fractures_families) and [http://england.shelter.org.uk/news/january\\_2010/housing\\_costs\\_forcing\\_delay\\_in\\_having\\_children](http://england.shelter.org.uk/news/january_2010/housing_costs_forcing_delay_in_having_children)

<sup>32</sup> Martin Wolf, Financial Times, July 10 2008 <http://www.ft.com/cms/s/0/69ebb588-4ead-11dd-ba7c-000077b07658.html>

## Chapter 2 The Financial Impact of Buy-to-Let Investment

In addition to the recent large growth in demand generated by the PRS and its impact on UK house prices, there are substantial reasons to be concerned about the *nature* of this demand.

### 2.1 *Buy-to-Let and Financial Volatility*

BTL activity has been highly **volatile**. The number of outstanding BTL mortgages increased ten-fold from mid 2000 to reach over one million by 2007.

To take a more specific example - the rate of growth of BTL mortgages as a proportion of house purchase lending accelerated at a staggering rate throughout 2006. The total of BTL mortgages for the first 6 months of 2006 was 152,000 and in the second half of 2006 it was 177,000. This is a 20% increase in identifiable investor consumption of housing in a very short period.

And as the consultation paper notes (see paragraph 5.16) the number of Buy-to-Let mortgages then fell – with 2008 seeing almost half the level of gross lending than the 2007 peak in lending. In turn, 2009 saw BTL mortgage halve again from 222,700 Buy-to-Let loans advanced in 2008 to 93,500 in 2009 – an additional 58% decline.<sup>33</sup>

The consultation paper is remarkably unreflective of the role this highly volatile pattern of lending played both in house price increases during the period, its impact on total market stability and the impact this has had on house buyers who have either been priced out or now find themselves in negative equity.

**Question: ‘Why is the government seeking to encourage a more volatile source of market demand in the UK residential housing market? How can the government take steps to ensure that volatility is reduced?’**

### 2.2 *Buy-to-Let and Speculative Investment*

BTL activity also appears strongly **speculative, which contributes further to its volatile nature**.

The consultation paper admits that BTL investment has been primarily based on the expectation of capital gain: “much of the return to current investment in the PRS comes from capital appreciation, as opposed to rental yield” (paragraph 6.4).

For most BTL investors, *current BTL yields are clearly negative when financing costs, voids and maintenance costs are taken into account*.

One study sponsored by the Department for Communities and Local Government found that: “by 2004, however, net rental yield was clearly moving downwards, making it a less attractive investment proposition in terms of rental income. This indicates that *expected capital gains alone have driven the most recent wave of investment in the sector*” [our emphasis].<sup>34</sup>

Any investment which generates negative income flows and is reliant upon expected growth in capital value *is by its definition speculative investment*. It is surprising the paper is unaware of this and is seeking to encourage further speculative investment from the PRS sector into the UK residential market.

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<sup>33</sup> Council for Mortgage Lenders, ‘Buy to Let lending in 2009’ <http://www.cml.org.uk/cml/media/press/2540>

<sup>34</sup> ‘Rapid evidence assessment of the research literature on the buy-to-let housing market sector’, ECOTEC and Professor Ian Cole at the Centre for Regional Economic and Social Research at Sheffield Hallam University, February 2008, commissioned by NHPAU <http://www.communities.gov.uk/documents/507390/pdf/684939.pdf>

**Question: 'Why is the government seeking to encourage speculative investment into the UK residential housing market?'**

### **2.3 Buy-to-Let and Investor Financial Vulnerability**

As well as being volatile and speculative, BTL lending is also higher risk and more financially vulnerable than mainstream Owner Occupation.

According to the Council of Mortgage lenders the majority of Buy-to-Let lending is based on interest only mortgages. This has possibly substantial longer term negative implications for BTL borrowers who are not making any reduction in their capital debt<sup>35</sup>

Low yields when set against outgoing mortgage costs suggest higher levels of vulnerability to shocks for the BTL sector. Initial poor or negative income flows and the higher possibility of income 'shocks' – notably through rental voids – means the ability to ride out short periods of financial stress may be more limited.

BTL investors may state that they are 'in it for the long term' but their poor financial yield, when combined with capital losses and negative equity means they are likely to be subject to short term pressures to sell – notably from tighter credit requirements from mortgage lenders.

This is often compounded by gearing – the use of remortgaging from previous properties to invest in new properties, a practice which tends to reduce the overall level of portfolio equity and any cushioning to price falls from previous market rises: a particular problem for as cyclical a market as UK housing.

According to one study almost half of all BTL landlords funded deposits on the purchase of another property by a remortgage on an existing BTL property (Scanlon and Whitehead, 2005).<sup>36</sup>

BTL investment also offers the ability to achieve substantial debt based leverage – unlike most other financial investments (such a practice is illegal for investing in the stock market). According to the CML "the ability to 'gear' their investment by borrowing has been one of the key attractions for Buy-to-Let landlords, allowing them to magnify the benefit of capital gain".<sup>37</sup> This enables BTL investors to multiple the benefits of price rises, but raises the risk of compounding losses from any price falls. This makes BTL a high risk investment with the ability to make losses much higher than the initial investment stake.

BTL investors are also more likely to get into repayment difficulties than mainstream borrowers. In 2009, according to the Council for Mortgage lenders, repossessions of Buy-to-Let properties were higher than in the UK residential mortgage market – substantially so, well over twice the rate, when the 'Receiver of Rent' mechanism available to creditors is taken into account.<sup>38</sup>

A study conducted by BDRC for Alliance and Leicester in 2007 added to this concern about BTL financial vulnerability – finding that 29% of BTL landlords were breaking even or making a loss based

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<sup>35</sup> The CML do not disclose how high this percentage is. Council for Mortgage Lenders, 'Buy to Let lending in 2009' <http://www.cml.org.uk/cml/media/press/2540>

<sup>36</sup> Scanlon K and Whitehead C (2005) The profile and intentions of buy-to-let investors CML: London

<sup>37</sup> 'The growth of Buy-to-Let', CML, *Housing Finance* Issue 09 2006

<sup>38</sup> Council for Mortgage Lenders, 'Buy to Let lending in 2009' <http://www.cml.org.uk/cml/media/press/2540>

upon income (this study did not take into account any additional financial loss from recent declines in capital value).<sup>39</sup>

**Question: 'Has the government considered what impact higher levels of BTL financial vulnerability has for the wider residential housing market?'**

**Question: 'What steps should the UK government take to place limitations on gearing within BTL portfolios?'**

**Question: 'Is it responsible or sensible for the UK government to be seeking to encourage significant numbers of UK small investors to undertake investment based upon debt based leverage on an assumption of possible capital gain?'**

## **2.4 Buy-to-Let, Wider Financial Stability and Costs to the UK Economy**

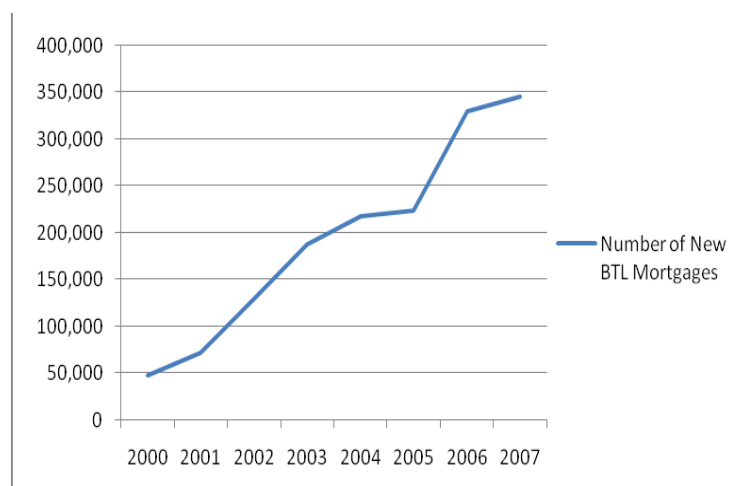
*"Some of the lending which has gone on of late has been madness, complete and utter insanity. ... If you've got a portfolio of 20 flats in city centres then God help you. There are far too many of them and they are far too expensive."*

*John Goodfellow, Chief Executive, Skipton Building Society<sup>40</sup>*

The BTL sector has been funded by financing sources that have proven highly unstable. This has not just been a problem for the health of the PRS sector but has imposed very large economic costs on the UK economy and taxpayer. Unbelievably, the consultation paper makes no reference to these highly damaging externalities of the PRS sector.

The main growth period in BTL mortgage finance – between 2000 and 2007 – occurred alongside the growth in reliance of the UK banking sector on wholesale market funding and on Mortgage Backed Securities issuance (see graph 5). This is no coincidence – these funding sources were pioneered by the major UK Buy-to-Let mortgage providers.

**Graph 4 – Number of New UK Buy-to-Let Mortgages 2000 - 2007**

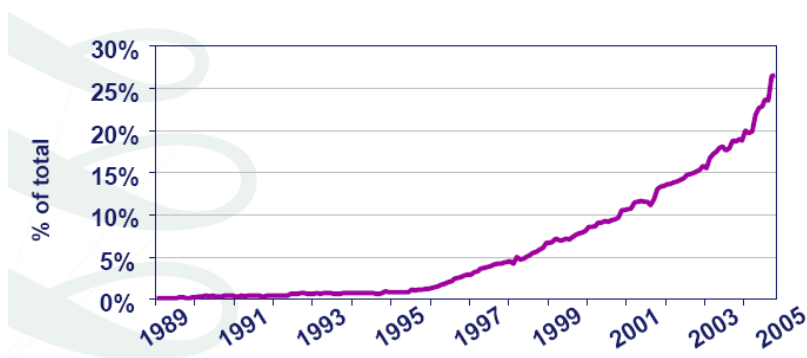


Source: Council for Mortgage Lenders

<sup>39</sup> See: <http://www.alliance-leicester-group.co.uk/html/media/non-indexed/release.asp?txtTable=pressreleases&txtCode=PR1701071>

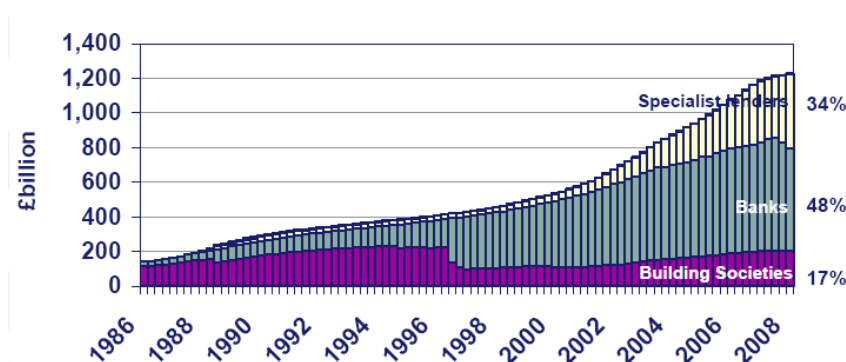
<sup>40</sup> Interviewed in Scotland on Sunday, 24<sup>th</sup> February 2008

**Graph 5 – Estimated Share of Securitised Loans in UK Mortgage Lending**



Source: FSA calculations, Bank of England, ONS, taken from 'The Mortgage Market: Issues for Debate', Adair Turner Chairman FSA Mortgage Conference 12 May 2009

**Graph 6 – UK Mortgage Balances Outstanding by Type of Lender**



Source: FSA calculations, Bank of England, ONS, taken from 'The Mortgage Market: Issues for Debate', Adair Turner Chairman FSA Mortgage Conference 12 May 2009

This higher risk sources of financing coupled with higher rates of BTL loan impairment has meant that **eight of the top nine UK Buy-to-Let lenders in 2007 have now either been rescued by the tax payer after threatened bankruptcy, are closed for further business or have been badly damaged by the financial crisis and are undergoing substantial retrenchment (see table 3).**

This is an astonishingly high casualty rate – much higher than in mainstream Owner Occupation mortgage lending during the credit crunch- and is perhaps unprecedented in the history of modern UK mortgage lending.

**Table 3 – Top 10 UK BTL lenders in 2007 and Current Trading Status**

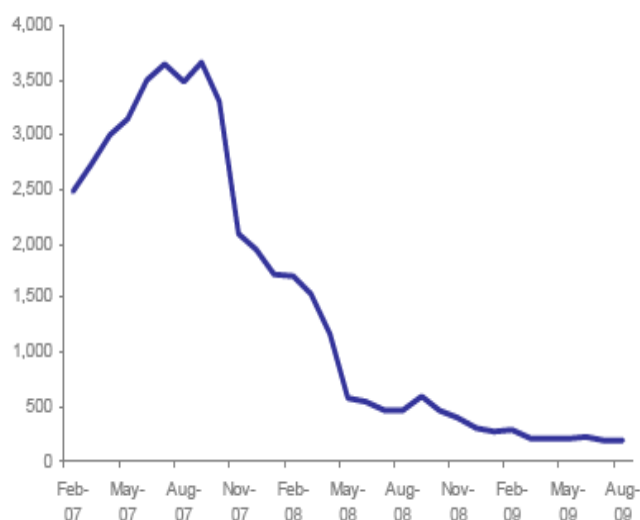
	<b>Lender</b>	<b>Parent Company</b>	<b>Current Status</b>
1	Mortgage Express	Bradford & Bingley	Closed to new business after parent company nationalised to prevent bankruptcy
2	Birmingham Midshires	HBOS	Trading at reduced volumes & parent company taken over and part nationalised
3	Paragon Group	-	Substantial restructuring, emergency rights issue and has ceased trading new mortgages

4	Bristol & West Group	Bank of Ireland	Ceased trading and parent company part nationalised
5	Cheltenham & Gloucester	Lloyds TSB	Trading at reduced volumes, parent company part nationalised
6	Northern Rock	-	Nationalised to prevent bankruptcy
7	Capital Home Loans	Irish Life & Permanent	Ceased Trading
8	Mortgage Works	Nationwide	Substantially reduced business
9	Mortgage Business	HBOS	Ceased trading and parent company taken over and part nationalised
10	Woolwich	Barclays	Continued trading

Source: CML / Paragon Mortgages ranked by balances outstanding in 2007<sup>41</sup>

This list of mainstream BTL lenders excludes substantial numbers of non-balance-sheet UK BTL mortgage originators who traded via specialist mortgage brokers – see graph 6 - for example GMAC RFC. Many of these have these have now ceased trading (see graph 7).

#### Graph 7 – Live Buy-to-Let Products Feb 2007 – Aug 2009



Source: CML and Paragon Mortgages<sup>42</sup>

#### Case Study: Buy-to-Let and Bradford & Bingley

Bradford & Bingley was the UK's largest provider of Buy-to-Let residential mortgages through its Mortgage Express brand. At the end of June 2008 its Buy-to-Let loans totalled almost £25bn out of a total mortgage book of £42bn

<sup>41</sup> Quoted in 'BTL credit performance, underwriting and regulation' presentation by John Heron from Paragon Mortgages to the CML, September 2009 <http://www.cml.org.uk/cml/filegrab/JohnHeronpresentation.pdf?ref=6576>

<sup>42</sup> Quoted in 'BTL credit performance, underwriting and regulation' presentation by John Heron from Paragon Mortgages to the CML, September 2009 <http://www.cml.org.uk/cml/filegrab/JohnHeronpresentation.pdf?ref=6576>

Before its nationalisation, Bradford & Bingley's shares had dropped 94% to 20p, the bank had undergone three failed attempts at rights issues and had failed to attract any alternative buyers. Intervention from the UK government led to the taxpayer underwriting a loan book of almost £900 million.

Bradford & Bingley's troubles stemmed from the quality of its loan book. Arrears – the percentage of loans not paid for three months or longer – were substantially higher at B&B than its peers. Most of its mortgages are Buy-to-Let, where values have fallen sharply, or self-certified, where borrowers do not have to offer any proof of their salary. In March 2009, B&B reported an extraordinary 20-fold increase in bad debts, rising from £22.5m in 2007 to £508m in 2008. The number of its mortgages three months or more in arrears trebled to 4.6% of its book in the last quarter of last year compared to 1.6% a year earlier.<sup>4344</sup>

**Question: 'What role did the financing model of Buy-to-Let lending play in the recent financial crisis and recession? Has HM Treasury sought to learn any lessons from this?'**

**Question: 'What role did the financing model of Buy-to-Let lending play in the collapse of Bradford and Bingley and other mortgage lenders? How much did this cost the UK economy in intervention costs and what impact has it had on damaging the reputation of the UK's financial sector?'**

**Question: 'Why was BTL mortgage lending not under FSA regulatory supervision?'**

**Question: 'Is the government prepared to accept these large damaging externalities caused by the PRS sector on the UK economy? What steps could it take to reduce the speculative element of BTL investment and recoup losses through additional taxation on the sector?'**

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<sup>43</sup> <http://www.propertyweek.com/story.asp?storycode=3124161>

<sup>44</sup> <http://www.guardian.co.uk/money/blog/2009/mar/31/buy-to-let-scandal-exposed>

## Chapter 3 Buy-to-Let and its Negative Impact on First Time Buyers

*“It has become much harder for First-Time Buyers to get onto the housing ladder in recent years. There were less than 200,000 in both 2008 and 2009, less than half the longer-run average.”*

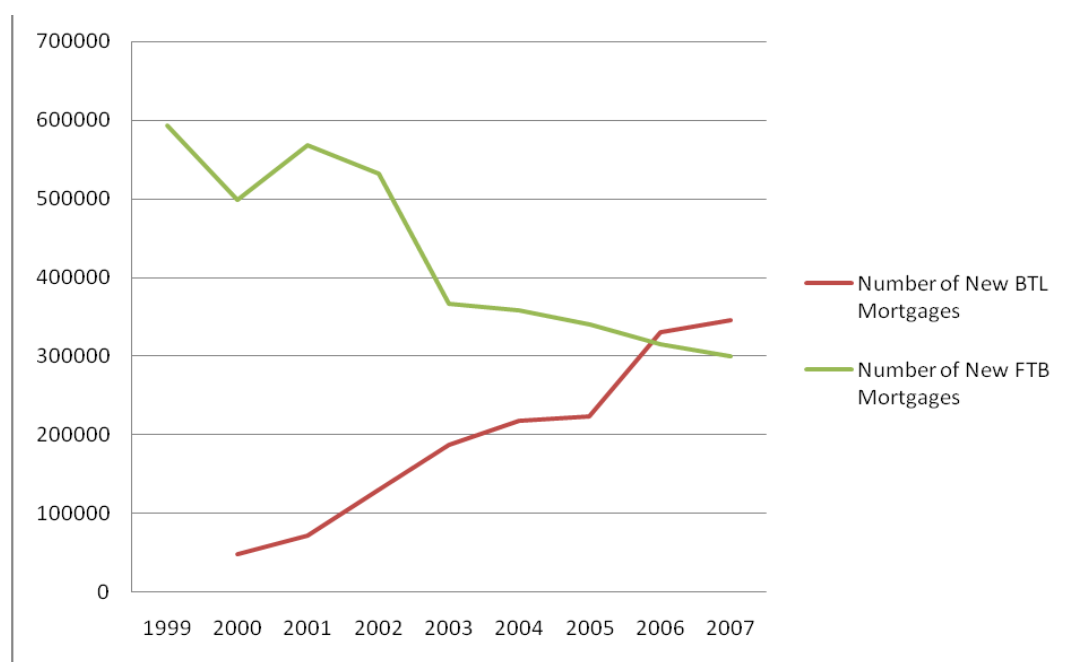
*Council for Mortgage Lenders<sup>45</sup>*

### 3.1 Buy-to-Let and First Time Buyers

First Time Buyers have been increasingly unable to enter the UK property market. As we have seen, the BTL sector has played a very important role in causing this. BTL has been an important driver for much higher UK house prices, BTL has absorbed many more homes than the private sector has been able to build (see Chapter 6) and has been competing directly with FTBs for the type of properties that FTB would have previously typically bought.

As graph 8 shows, there is a striking correlation between declining numbers of First Time Buyers and increasing numbers of BTL mortgages over the past ten years.

**Graph 8 – New Buy-to-Let and First Time Buyer Mortgage Lending 1999 - 2007**



Source: CML BTL mortgage lending data, Halifax First Time Buyer Review 2007

Analysis from the National Housing and Planning Advice Unit (NHPAU) suggests “that as many as 1.2 million ‘new’ households cannot be formed in England alone because high housing costs oblige young adults to stay at home or sharing”.<sup>46</sup>

In addition, RICs have calculated that high house prices have led to around 1.4m fewer First-Time Buyer mortgages since 1999.<sup>47</sup>

<sup>45</sup> Source ‘Affordability and First Time Buyers’, CML Housing Finance Issue 01 2010)

<sup>46</sup> ‘Affordability – more than just a housing problem’, NHPAU, May 2009

The assumption contained in the consultation paper is that greater levels of FTB postponing home ownership and renting is one of choice – due to greater flexibility and cultural changes (paragraphs 2.4 & 2.7). Unfortunately this isn't supported by the evidence.

In a recent survey by Rightmove, 61% of people who expected to live in a rented property for 2010 said they would like to buy a home but could not afford to do so. Just 13 percent of people who plan to rent said they were doing so out of choice, rather than necessity.<sup>48</sup>

Why have BTL investors been able to displace FTBs? The primary cause is the significant financial advantage that BTL investors have over FTBs when buying UK residential property.

This is something that the consultation paper hints at in paragraph 2.6 when citing figures that “in 2007, rents [were] around 24% to 40% lower than mortgage payments for the same property” – in a market where BTL had an equal financial footing to FTBs how could this disparity occur?

There are two significant components of BTLs financial strength over FTBs:

- BTL investors use financial products that give them greater purchasing power than FTBs
- BTL investors have substantial advantages under the UK tax system over FTBs

### ***3.2 Buy-to-Let, Financial Products and Purchasing Power***

BTL investors benefit from using financial products that give them greater purchasing power than First Time Buyers.

There are two areas where this is pronounced:

- ***Interest Only vs. Repayment Mortgages***

According to CML “most Buy-to-Let mortgages are taken out on an interest-only basis”<sup>49</sup> (Although it does not publish a precise figure so it is difficult to gauge how large this percentage is, the mortgage product profile of the major UK BTL lenders suggests that it is a very substantial amount of BTL mortgages).

In contrast a large majority of FTBs use repayment mortgages. In December 2009, 90% of mortgages advanced to First Time Buyers were repayment mortgages.<sup>50</sup>

The use of interest only mortgages means that an investor does not have to pay the additional costs of paying down the overall capital – giving them additional purchasing power in the housing market relative to First Time Buyers. This additional purchasing power increases the lower that levels of interest rates are – something of greater relevance in the low interest rate environment of the past decade.

***Question: ‘Should interest only mortgages be permitted to be used by BTL investors? Should capital repayment vehicles be made a mandatory obligation for BTL investors?’***

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<sup>47</sup> <http://www.telegraph.co.uk/finance/newsbysector/constructionandproperty/2821472/First-time-buyers-set-to-rescue-house-prices.html>

<sup>48</sup> <http://www.telegraph.co.uk/finance/personalfinance/borrowing/mortgages/7261604/House-prices-60pc-of-renters-are-priced-out-of-the-market.html>

<sup>49</sup> <http://www.cml.org.uk/cml/media/press/2272>

<sup>50</sup> <http://www.cml.org.uk/cml/media/press/2543>

- ***Yield vs. Affordability***

BTL investors and lenders also tend to calculate the rationale of their investment based upon yields and the efficiency of capital allocation, rather than more traditional levels of affordability ratios of price to income.

FTBs are looking at the cost of somewhere to live based against their incomes and lenders look primarily at lending to income ratios.

Although there are many variables in calculating what this means for the overall level of pricing of UK housing, *in a market of limited supply a large BTL market presence would tend to push up the price of housing to a level at which it becomes reflective of the marginal profit rate between rental income and overall income yield.*

In an environment of high housing demand and low levels of either financing cost or alternative returns on investment (for example from a savings account) this price rationale for individual UK properties would tend to be higher than traditional price to income ratios used by First Time Buyers.

This again gives PRS investors an advantage over First Time Buyers

These financial advantages also pose concerns about the role the PRS sector may have in increasing risk levels for FTBs. In raising the overall market price level for typical First Time Buyer properties, BTL financing also raises the overall risk level for potential First Time Buyers. BTL investors are taking substantial risks on debt gearing ratios, their assumption of capital gain and in their ability to pay the final capital value upon loan maturation. If they want to compete in the same market, FTB's have to expose themselves to these levels of risk and vulnerability on market pricing.

This concern is backed up by historical data analysing FTB mortgage financing. In 1984, the average FTB used income multiples of 1.99 to obtain a mortgage, by 2004 this figure was 3.03. In the mid 1990s only 1 percent of FTB mortgages were based on income multiples of 4.0 or above, by 2005 this applied to 20 percent of them.<sup>51</sup>

***Question: 'What is the government's view of the impact of BTL financing on UK residential house pricing? Is it concerned about the implications this has for FTB risk exposure?'***

### ***3.3 Buy-to-Let and Tax Advantages over First Time Buyers***

BTL investors currently benefit from significant tax advantages over First Time Buyers.

BTL investors are able to deduct interest payments as a business cost against tax. As the majority of BTL investors use interest only mortgages this means the main financing costs of purchase is tax deductible. BTL investors are also able to deduct other expenses, such as repairs, insurance, legal costs, against the cost of their 'business'.

Any gains that a BTL property is gifted from rising property values are also taxed at an 18% rate through capital gains tax - lower than the tax a FTB would pay on earned income. BTL investors would also get an annual capital gains exemption for each owner (e.g. husband and wife) of £8000.

First Time Buyers, in contrast, have to pay their mortgage costs out of net income. They have to pay for any repairs, insurance and legal costs from net income. This represents a significant loss of purchasing power.

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<sup>51</sup> 'Affordability – more than just a housing problem', NHPAU, May 2009

The CML have recently conducted analysis that helps illustrate how large this disparity in purchasing power is from tax advantages and the use of interest only mortgages.

According to CML the average proportion of income First-Time Buyers spend on mortgage interest payments in August 2009 was 15% of *gross* income.<sup>52</sup>

However, most First Time Buyers have repayment mortgages and all have to pay mortgages after paying income tax. CML have also estimated that the typical capital and interest payments of an average First Time Buyer in 2009 would represent about 29% of take-home income.<sup>53</sup>

This gives a good indication of the impact that tax disadvantage and use of repayment mortgages has on FTB purchasing power over BTL purchasers. Assuming a similar income profile, ***BTL investors' mortgage costs – given their tax advantages and use of interest only mortgages – amount to just over a seventh of their net income, whereas FTB average mortgage costs amount to a nearly a third of net income.***

This is a very large gap and one that help explains how, on the same income, a BTL investor will be able to pay substantially more for any one property. It also may help explain why UK data on First Time Buyer purchases since 2003 has appeared to depart so substantially from historical price to income ratios.

In a UK taxation system that has a long history of being both progressive and in favour of Owner Occupation. In a political climate where support for FTBs is given much emphasis this distortion against FTBs is striking. The tax advantages for the BTL sector are both regressive and create a distortion that helps imbalance the UK residential market – which is widely perceived as having negative knock on effects for social outcomes.

*“Taxation of property should be heavier, not lighter. But it should also be less regressive. ... Higher taxation would also lower the intensity of property speculation. Can anybody doubt the damage that highly geared purchases of property can do to the financial sector, the economy and even the purchasers? The British have become a nation of property speculators. Today, as usual, the hope is that houses should be as expensive as possible. But a house is a place to live, not a good way for people, let alone a nation, to become rich. ... the UK should try to raise more revenue from property taxes.”*

*Martin Wolf, Financial Times*<sup>54</sup>

Levels of taxation on property in the UK are already extremely low when compared to income and to other assets.<sup>55</sup> Whilst avoidance of Capital Gains Tax, particularly by BTL investors, is widespread. CGT avoidance includes changing the assignment of primary residence to gain total exemption at sale. Another is the ability of BTL investors to release funds through remortgaging – which postpones the payment of capital gains, and if the property is never sold the capital gains tax due is never paid.

***Question: ‘Why is the UK government giving tax advantages to private investors who create little or no additional wealth for the UK economy?’***

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<sup>52</sup> [http://www.politics.co.uk/opinion-formers/press-releases/employment/cml-media-note-in-advance-of-mpc-decision-\\$1332671\\$364298.htm](http://www.politics.co.uk/opinion-formers/press-releases/employment/cml-media-note-in-advance-of-mpc-decision-$1332671$364298.htm)

<sup>53</sup> This was based on an estimated effective tax rate for recent first-time buyers in 2009 was about 25%. Source ‘Affordability and First Time Buyers’, CML Housing Finance Issue 01 2010

<sup>54</sup> Financial Times, September 24 2009

<sup>55</sup> See ‘A Survey of the UK Tax System’ Institute of Fiscal Studies, April 2009

**Question: ‘Why is the UK government not seeking to remove the distortion in favour of BTL investors over First Time Buyers and Owner Occupiers?’**

**Question: ‘Why is the UK government seeking to increase tax distortions in favour of BTL investors over FTBs?’**

The proposal put forward in the consultation paper on Stamp Duty Land Tax (SDLT) to reduce the tax burden on multiple property purchases from property investors (see paragraph 6: *“in most cases this would result in a lower SDLT bill, it will never result in a higher bill”*) would further increase the tax advantage of BTL investors over Owner Occupiers and First Time Buyers. This proposal is highly worrying and difficult to justify either on wider economic or social grounds – particularly at a time of such pressure on public finances.

**Question: ‘What loss of revenue would the SDLT tax break cause to the UK exchequer?’**

**Question: ‘What additional revenue to the UK government could the PRS sector contribute through higher taxation?’**

## Chapter 4 Institutional Investment and the UK residential property market

### ***4.1 Institutional Investment and Increased Demand in the UK Housing Market***

The aim of the government to increase institutional investment into the UK residential housing market amplifies many of the concerns about the impact of Buy-to-Let from individual investors.

As already noted, increasing the volume of money in a market with relatively fixed supply will lead to an increased upwards pressure on house prices.

This is something the consultation paper recognises, albeit does not put great emphasis on (see paragraph 6.22; *“Additional investment, particularly if geographically concentrated, and/or directed into the existing stock, could be expected to have some impact on house prices”*).

The total additional volume of finance available through external financial investors is potentially very large indeed – be it from UK pension funds, property unit trusts or other financial vehicles be they UK based or global. Such large financial flows into the UK residential property market would undoubtedly have a powerful upwards impact on UK house prices. The consultation paper cites approvingly the £25 billion worth of property funds under the management of just one institutional investor, Avia Investors [paragraph 6.14]. Yet £25 billion represents nearly 20% of gross annual UK residential mortgage lending in the UK – enough to have a very substantial price impact.<sup>56</sup>

### ***4.2 Institutional Investment and Volatility***

Increasing reliance on funding from investment finance is also likely to increase the volatility of the UK residential housing market.

The experience of the UK commercial market over the past six years is instructive here.

Between 2004 and 2007, UK commercial property saw huge net flows into Property Unit Trusts (PUTS), Limited Partnerships and other indirect investments. The traditional investor base of UK pension funds also broadened to include high-net worth and overseas investors and growing numbers of retail investors.

Pooled property funds, invested £7.7bn of new money between 2004 and 2006, over six times larger than net investment in the previous three years. In 2006 alone, retail investors placed a net £3.6bn into commercial property funds.<sup>57</sup> Another source estimated that new small investors put about £15bn into property unit trusts - £5bn pouring in during 2006 and early 2007 alone.<sup>58</sup> As graph 9 shows, this rapidly increased the volume and type of money entering the UK commercial property market.

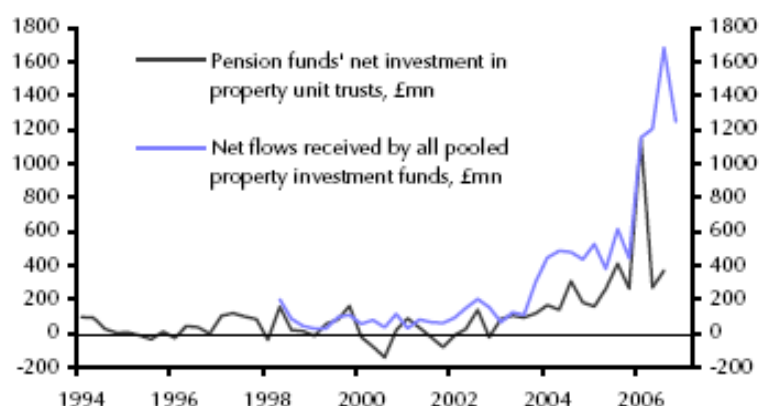
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<sup>56</sup> CML data, Gross Mortgage Lending in 2009 was £143,506 million.

<sup>57</sup> Capital Economics, ‘UK Commercial Property Focus’, May 2007

<sup>58</sup> Guardian 18 Jan 2008 <http://www.guardian.co.uk/money/2008/jan/18/property.moneyinvestments>

**Graph 9 – Net Investment in Indirect Commercial Property Investment Vehicles, 1994 – 2006, £million**



Source: ONS, Association of Real Estate Funds, Capital Economics<sup>59</sup>

As Capital Economics has noted, these new funds represented additional risk factors that were not present in previous UK commercial property cycles.<sup>60</sup> The short term and global nature of these funds made a reversal more likely even through small changes in perceptions of investor risk from UK residential property or the UK economy.

Commercial property markets were therefore more vulnerable to a shift in investor sentiment and in 2007 these indirect investment flows went into reverse and acted as a catalyst for a very large market correction. In the period since 2007, UK commercial property prices collapsed 44% in just over two years – twice as fast and nearly twice as hard as the 1989-93 crash.<sup>61</sup>

**Question: 'How desirable is increasing the volume of volatile external investment flows into the UK residential property market?'**

### **4.3 Wider Policy Implications for the UK Housing Market**

In the context of the stated UK government policy objective of improving housing affordability, it is by no means clear that the increase in supply that could be gained from additional investment capital would outweigh the negative effects of higher market prices that this capital could cause. Nor is it clear from the consultation paper that the government is thinking of these questions.

Given the size of the total UK housing market stock, any additional supply boost from new investment capital is likely to be very small and thus result in a relatively small downward pressure on prices. In contrast, investment capital inflows impact on residential market demand is likely to be immediate and large.

The consultation paper is not clear in how the government would seek to address questions of how to limit the impact of institutional investment capital on the wider residential market. Given the size of potential new investment flows, this is worrying.

<sup>59</sup> Capital Economics, 'UK Commercial Property Focus', May 2007

<sup>60</sup> Capital Economics, 'UK Commercial Property Focus', May 2007

<sup>61</sup> Financial Times, September 18<sup>th</sup> 2009 <http://www.ft.com/cms/s/2/d6ff1cea-a47a-11de-92d4-00144feabdc0.html>

Nor is it clear that the public benefit to be gained from any additional levels of market supply would justify the continued tax breaks already offered to institutional investors in UK property through the UK Real Estate Investment Trust (REITs) and the disadvantage this gives to Owner Occupiers and First Time Buyers.

The consultation paper only asks question relating to the barriers facing institutional investment in the UK residential property market and what could be done to reduce these. It does not raise any questions about the negative impacts on the wider residential market and the potential social and economic downsides associated with this (see paragraph 6.22; “*the Government is ... interested in any evidence of the net benefits institutional investors might bring to the UK residential property market*”). It seems odd for a government committed to evidence-based policy making to only be asking for evidence supporting one side of a cost benefit analysis.

***Question: ‘Why is the consultation paper not interested in further understanding the potential negative impacts of increased investment flows into the UK residential property market?’***

There are much wider political questions to be raised for a strategy to increase global investment flows into a housing market that has such important social linkages and distributional consequences.

The UK residential housing market has previously been one that is substantially socially imbedded with market pricing based upon ratios of average wages and often (in the case of building societies) collective local saving and lending institutions.

The step to explicitly encourage financial flows into the UK residential property market from investment vehicles is one that would lead to the further financialisation of the residential market and of residential market prices. This potentially brings with it substantial negative social and distributional impacts.

## Chapter 5 Buy-to-Let, Housing and Wealth Distribution

*“The trouble here is that housing bubbles (unlike other investment bubbles) do not generate an increase in income-generating assets. Yes, if people rent out property, they make money. They may also benefit from the rise in prices. But this is mainly a question of redistributing wealth.”*

*Andrew Farlow, Oriel College, Oxford<sup>62</sup>*

*“The money borrowed by young families ended up in the bank accounts of older households...The increase in house prices over the decade to 2007 – and the massive financial flows associated with that appreciation – represent a huge redistribution of wealth between different households within our society.”*

*Spencer Dale, Bank of England Chief Economist<sup>63</sup>*

*Quote: “[UK] Landlords tend to be wealthy, with relatively high numbers found in the groups with the highest income, highest socio-economic status or those living in the wealthiest neighbourhoods.”*

*Mintel 2007<sup>64</sup>*

### 5.1 Housing and Growing UK Wealth Inequality

Several studies (ONS, IPPR and recently David Willetts)<sup>65</sup> identify increasing **inequality in housing wealth as an important driver of widening inequalities in wealth distribution in the UK** – both between social classes and between generations.

IPPR identify increasing inequality in housing wealth as one of the main drivers of overall levels of UK wealth inequality.<sup>66</sup>

The Office for National Statistics ‘Wealth in Britain’ study, covering the 2006-08 period, showed that UK household wealth disparities far outstrip those of disparities in income. The wealthiest half of UK households had 91% of UK total wealth. The wealthiest 10% own 44% of the country’s personal assets and were nearly five times more wealthy than the bottom half.

Household wealth, estimated at £9,000bn, is dominated by pensions and property assets, each accounting for two-fifths of the total. The other components, financial wealth and physical wealth – such as cars and antiques – each accounted for one-ninth of the total.

Property wealth is more unevenly distributed than income and physical wealth. 30% of households have no or negative household wealth, whilst the distribution of property wealth represented a Gini coefficient of 0.62 – a high level of inequality (the Gini coefficient takes a value between 0 and 1, with 0 representing a perfectly equal distribution and 1 representing ‘perfect inequality’). For comparison,

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<sup>62</sup> ‘UK House Prices, Consumption and GDP in a Global Context’, Andrew Farlow  
<http://www.economics.ox.ac.uk/members/andrew.farlow/Farlow%20Housing%20and%20Consumption.pdf>

<sup>63</sup> Spencer Dale speech, ‘Separating Fact from Fiction’, 24 September 2009. Available:  
<http://www.bankofengland.co.uk/publications/news/2009/071.htm>

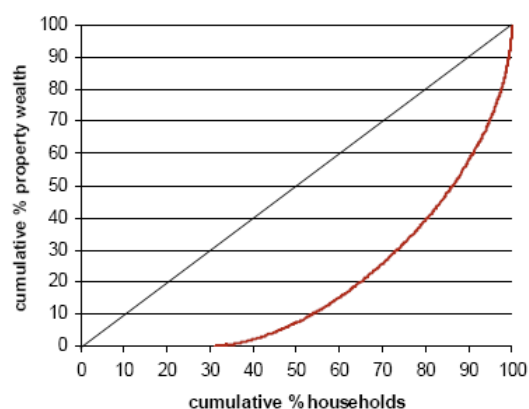
<sup>64</sup> Quoted in ‘BTL credit performance, underwriting and regulation’ presentation by John Heron from Paragon Mortgages to the CML, September 2009 <http://www.cml.org.uk/cml/filegrab/JohnHeronpresentation.pdf?ref=6576>

<sup>65</sup> ‘The Pinch: How the Baby Boomers Took Their Children’s Future – and Why They Should Give it Back’, David Willetts, Atlantic Books, 2010

<sup>66</sup> ‘Housing Wealth: First timers to old timers’ Dominic Maxwell and Sonia Sodha, IPPR, June 2006

in 2007 the UK's income equality Gini coefficient was 0.36, Brazil's was 0.55 and South Africa's was 0.58.<sup>67,68,69</sup>

**Graph 10 – UK Distribution of Net Household Property 2006/08**



Source: Office for National Statistics

Inter generational inequalities in housing wealth are now highly pronounced. According to new data, the aggregate value of housing wealth held by those aged 50 to pension age – 60 for women and 65 for men (7.1 million people) – was £1,280bn, more than twice the housing wealth held by any other age group. The next wealthiest group were those between pension age and 75 (5 million people), whose housing wealth was £600bn. This is despite these groups being smaller in population terms than the 35-44 age group (8.9 million).<sup>70</sup>

There are also clear signs that the ability of younger age groups to access housing assets is increasingly dependent upon existing family wealth. In 2008, 80% of First Time Buyers under the age of 30 relied on parental assistance.<sup>71</sup>

## 5.2 The Distributional Impacts of the Private Rented Sector

However the distributional impacts of the PRS sector, both through its macro level impact on increasing housing prices and in the rents PRS investors secure over tenants – many of whom may be priced out First Time Buyers – are completely unexamined in this consultation paper.

Most PRS investors are existing Owner Occupiers, from wealthier parts of the population and demographically older.

<sup>67</sup> Property wealth appears to be a very important factor driving the wealth of medium to well off income groups. From the 4th to the 8th deciles of the UK population, net property wealth is the largest component of total wealth; it is most important in the 5th and 6th deciles, where it made up over half of the total, in the 9th and 10th deciles, net property wealth accounted for 39 and 32% of total wealth respectively.

<sup>68</sup> Office of National Statistics, 'Wealth in Britain' Survey, 2010. [http://www.statistics.gov.uk/downloads/theme\\_economy/wealth-assets-2006-2008/Wealth\\_in\\_GB\\_2006\\_2008.pdf](http://www.statistics.gov.uk/downloads/theme_economy/wealth-assets-2006-2008/Wealth_in_GB_2006_2008.pdf)

<sup>69</sup> UN Human Development Report 2009 <http://hdrstats.undp.org/en/indicators/161.html>

<sup>70</sup> See Financial Times, 16 February 2010, <http://www.ft.com/cms/s/0/c3cc07bc-1b3c-11df-953f-00144feab49a.html#>

<sup>71</sup> Council for Mortgage Lenders data

The growth of the PRS sector represents a greater concentration of wealth in the hands of private investors. In the short term the advantages the PRS sector hold over FTBs allows them to collect rents from priced out potential buyers. In the long term it also further concentrates the distribution of this asset – diverting it away from the broader base of Owner Occupiers and diverting the wealth uplift from rising property prices into a smaller number of hands.

The tendency of house prices to rise is also, in large part, the function of explicit government intervention – through restricting development via the planning system and the failure to counter balance the resulting excess levels of demand through higher levels of property taxation or other forms of demand management.

Unlike other investments, gains from increasing house prices are not the result of increased productivity growth or economic innovation but are much more characteristic of a windfall based upon capturing of value from within a state controlled market.

***Question: ‘What role would a growing PRS sector have in further concentrating wealth inequality?’***

***Question: ‘To what extent does the PRS sector capture of further housing capital gains represent a windfall and how could the government seek to recoup this windfall from the PRS sector?’***

***Question: ‘Why is the government seeking to give further tax advantages to property investors in an asset that is so unequally distributed?’***

## Chapter 6 Housing Supply, Buy-to-Let and the Impact on Owner Occupation

### 6.1 Buy-to-Let and UK Housing Supply

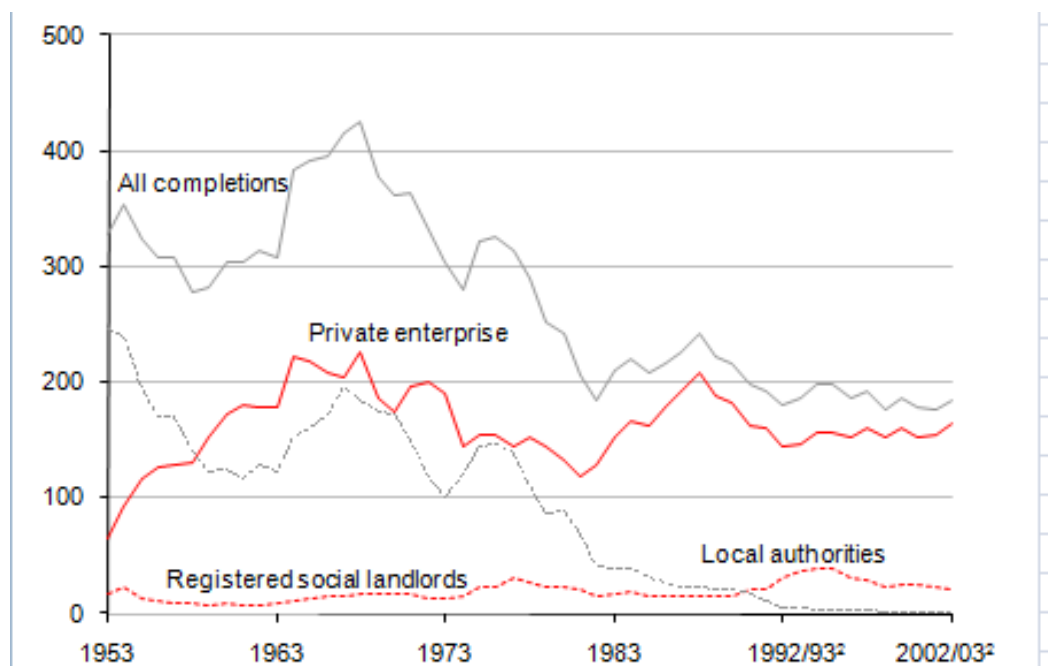
The consultation paper asserts that PRS has been a positive force for new housing supply. Yet this issue is not explored in any rigorous way.

- The consultation paper fails to consider in any robust way the relation between PRS demand and the supply response of the UK housing stock.
- The consultation paper also considers supply only in the context of the PRS sector – without considering its impact on supply within the Owner Occupation sector (see paragraph 5.7).

*Has the PRS sector been a significant driver in new supply?*

Between 2002/2003 and 2006/2007 – a period of very large growth in the BTL sector, when BTL mortgages rose by over 100% - new housing completions rose from 124,460 to 145,680 – an increase of just 17%.<sup>72</sup> Any supply response that can be attributed to the BTL sector is therefore clearly not a very powerful one. Nor is it one that adequately compensates for the overall increase in BTL demand – the annual increase in market housing supply between the year 2002/03 to the year 2006/07 represents only a fifteenth of the total number of BTL mortgages taken out in 2006/07.

**Graph 11 – UK Housebuilding Completions by Sector (Thousands)**



2. From 1990/91 data are for financial years

Source: ODPM; National Assembly for Wales; Scottish Executive; Department of the Environment, Northern Ireland, ONS

It also doesn't look convincing when compared against long term trends in historical supply (graph 11).

<sup>72</sup> Communities and Local Government House Building Statistics, via ONS website

145,680 new private sector completions are clearly moderate when compared to previous high private sector house building periods in the 1980s, 1960s and 1950s. As Buy-to-Let did not exist in the previous periods, it is worth the government considering in more detail what drove these previous high levels of private sector house building.

Nor does the consultation paper factor in the slump in house building that has occurred in 2008/09 and 2009/10 – caused in large part by the consequences of the loose lending and financial instability to some extent inherent in the BTL boom period.

What is also clear from this historical graph of completions is that the primary area of government policy failure for the past thirty years has been a gross failure to build adequate levels of social housing – despite us being a much wealthier society. The main ‘housing supply gap’ has been a social housing not a private sector one.

## 6.2 BTL Impact on Supply in the Owner Occupation Sector

As table 4 demonstrates, in every year from 2003/4 to 2008/09, the number of Buy-to-Let Mortgages outstripped the number of new market housing completions.

In these six years, between 2003/04 and 2008/09 the net loss of total UK housing market supply from Owner Occupation to BTL mortgage purchasers was 647,300 dwellings. In short, despite substantial levels of private sector house building, BTL purchases has led to the stock of Owner Occupation houses declining by nearly two thirds of a million homes. ***Rather than building new homes, since 2003 government housing policy has effectively removed at least 647,300 British homes that First Time Buyers can buy – flying in the face of government rhetoric to be helping First Time Buyers.***

**Table 4 – Net Annual Loss of Owner Occupation to BTL dwellings in UK Housing Supply 2003-09**

	<b>New UK Private Sector Housing Completions</b>	<b>New UK Buy-to-Let Mortgages</b>	<b>Net Annual Loss of UK Housing Supply from Owner Occupation to BTL</b>
<b>2003/04</b>	172,360	187,600	15,240
<b>2004/05</b>	184,500	217,700	33,200
<b>2005/06</b>	189,680	223,800	34,120
<b>2006/07</b>	192,130	330,300	138,170
<b>2007/08</b>	187,230	346,000	158,770
<b>2008/09</b>	139,250	222,700	83,440

Sources: DCLG housing statistics and Council for Mortgage Lenders data

It is important to note that this is probably a dramatic understatement of the likely total size of the BTL sector given the widespread use of other sources of finance to source BTL investment. Michael Ball from Reading University estimates that only 54% of BTL landlords use mortgage finance for

purchasing their properties, and not all of this mortgage finance will be in the form of BTL mortgage finance.<sup>73</sup>

This finding is backed up by other studies looking at new build supply. A survey of who bought new homes in London in 2006 by the Greater London Authority and the London Development Agency found that only 30% of purchasers were by Owner Occupiers whilst the remaining 70% were property investors.<sup>74</sup>

Rather than contributing to new supply towards Owner Occupation, the BTL sector is depriving it of supply.

*“What is also quite clear is that far from ‘adding to supply’ and helping to expand the housing market, BTL investment is simply **switching ownership of a fairly static stock**. Since 2003 BTL purchases have significantly exceeded the level of new supply (measured as new completions) so they are eroding the stock owned by household owner occupiers. ... [This] is a significant issue for housing policy predicated on promoting home ownership.”*

*Nigel Springings, University of Glasgow<sup>75</sup>*

It would be more accurate for the consultation paper to say that, rather than have an overall net positive effect on market supply, BTL has redistributed current and new supply away from Owner Occupation and to the PRS sector.

**Question: ‘Is it a government objective to reduce the number of homes available for Owner Occupation in the UK?’**

**Question: ‘Is the government happy that despite six years of private market house building there has been a net loss in property available for Owner Occupation?’**

Given the widespread political and local opposition to building new houses, it is also worrying that all new supply since 2003 has been so heavily negated by the growth of the BTL sector.

This evidence undermines government arguments around the need to build homes for ‘First Time Buyers’ and risks reducing the political legitimacy of the government’s house building programme. Arguing for building on green fields in order to help private BTL investors is not a convincing way to build support for a loss of a perceived communal good.

### **6.3 Buy-to-Let – Providing the Wrong Supply Incentives?**

There is a strong basis for believing that the boom in BTL lending and their higher purchasing power, combined with highly restrictive planning policies, has distorted incentives for developers to shift activity into building stock that is suitable for investment buyers rather than meeting the needs of Owner Occupiers and society as a whole (something the consultation paper implicitly recognises – see paragraph 5.7).

There are a series of studies that back up this view.

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<sup>73</sup> Ibid

<sup>74</sup> London Development Research (2006) Who buys new market homes in London? The Greater London Authority/London Development Agency: London

<sup>75</sup> Buy-to-let and the wider housing market, Nigel Springings, University of Glasgow

The number of new flats as a percentage of private sector completions rose from 12% in 1997/98 to 40% in 2004/05 (source CLG). Yet when polled by Mori only 2% of the UK population expressed a desire to live in modern apartments.<sup>76</sup>

BTL investment has spurred developers to construct smaller, studio apartments (Knight Frank Residential Research, 2007<sup>77</sup>; Rowlands et al, 2006<sup>78</sup>). This is because rental yields can be higher in these units (Allen and Blandy, 2004)<sup>79</sup>

This association is further demonstrated by evidence from lenders that BTL investors bought properties cheaper than average prices, £78,000 compared to more than £100,000 (Pannell and Heron, 2001).<sup>80</sup> This study also suggested that 80% of rented properties held by residential landlords was made up of flats and terraced houses. Gibb and Nygaard (2005)<sup>81</sup> found consensus among stakeholders that BTL activity targeted one- and two bedroom properties at the lower end of valuations.

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<sup>76</sup> Source Ipsos Mori 2002, <http://www.ipsos-mori.com/researchpublications/researcharchive/poll.aspx?oltemId=972>

<sup>77</sup> Knight Frank Residential Research (2007) Central Nottingham Housing Market Analysis Knight Frank: London

<sup>78</sup> Rowlands R, Murie A and Tice A (2006) More than Tenure Mix: Developer and purchaser attitudes to new housing estates Joseph Rowntree Foundation by the Chartered Institute of Housing: Coventry

<sup>79</sup> Ibid

<sup>80</sup> Pannell B and Heron J (2001) 'Good bye to buy-to-let?' Housing Finance 52, November 2001 pp18-25

<sup>81</sup> Ibid

## Chapter 7 Tenants' Rights

### 7.1 *Buy-to-Let and UK Tenants' Rights*

The Treasury paper cites the 1988 Housing Act as a turning point for the level of Private Rented Sector investment in the UK housing market. The 1988 Housing Act removed rent controls and introduced 6 month short-hold tenancies. Section 21 of the Act introduced the mandatory 2 month notice to quit, which gave landlords the power to serve tenants 2 month's notice without having to provide a reason. Even so, as the Treasury paper acknowledges, 'recovery in the PRS was initially slow', and it was not until the late 1990s that the exponential growth in the Buy-to-Let sector began.

The key question is why the boom did not begin until the late 1990s? This paper, surprisingly, fails to acknowledge the impact of a key amendment to the 1988 Act, which was not made until 1996. This amendment enabled landlords to serve the 2 month notice to leave *regardless of whether the tenant had signed a prior agreement* - between 1988 and 1996, landlords were finding that the law did not support the eviction, and that Section 21 was difficult to enforce. Without an assurance that the tenant can be evicted, property investment, and particularly Buy-to-Let investment, becomes more restricted.

### 7.2 *European Comparisons of Tenants' Rights*

Chapter 4 of the Treasury paper points to international comparisons and highlights the fact that, in other European countries such as Germany and France, the Private Rented Sector represents a larger share of the housing market, as high as 50% in Germany. However, what the consultation paper noticeably fails to acknowledge is the significantly stronger security of tenure that tenants in these countries have. As table 5 shows, in Germany, for instance, landlords must give a specific reason for evicting their tenants, and the eviction process can take up to 12 months. By comparison, landlords in the UK can serve 2 months notice to quit and are not required to cite a reason. A typical tenancy agreement in France is 3-4 years in length, and is often unlimited in Germany. This compares to the standard 6 month short-hold tenancy agreement in the UK. The consultation paper's strong assumption is that reduced regulatory 'burdens' on the PRS sector hold the key to higher levels of PRS holdings (see paragraphs 4.2 and 5.1) yet the European experience suggest no such direct correlation.

Table 5 below shows the rights of UK tenants compared to their European counterparts:

### 7.3 *Security of Tenure and Sustainability of PRS Investment*

Security of tenure for those living in private rented accommodation in the UK has a direct impact on the type of investment that the UK government can expect to see from private sector property investors.

In France and Germany, investment in the PRS is more sustainable: prospective investors must finance their investments based on the assumptions that their tenants have the right to stay in the property for a significantly longer period of time than in the UK, with contract lengths in Germany often unlimited. Rental yields are therefore much more important than investors calculations of potential capital gain. In contrast, the lack of security of tenure faced by UK tenants enables investors to purchase properties on an entirely speculative basis, safe in the knowledge that tenants can be evicted quickly and easily. The insecure and speculative nature of investment in the UK private sector, and its corresponding volatility, is highlighted elsewhere in this paper (Chapter 2).

**Question: 'What type of investment does the UK Government wish to see from investors in the UK Private Rented Sector? Can improving the security of tenure of tenants help reduce the level of speculative investment in the UK PRS sector?'**

***Question: 'Does the Treasury intend to conduct research into the correlation between the sustainability of PRS investment and the security of tenure experienced by tenants in the UK?'***

**Table 5 – Security of Tenure in Selected European Countries**

	Typical length of contract?	How much notice required from landlord	% Privately rented dwellings	What reason needed to evict?	Possible to appeal?
Germany	Majority are <i>unlimited</i> contracts.	If it would result in hardship, tenant can force continuation for up to 1 year.	51% (2002)	Very specific reason required.	Yes, a landlord's legitimate reason can be overridden for up to a year if causes hardship to the tenant.
France	Minimum of 3 years/ 1 year minimum contract (unfurnished/ furnished).	Minimum 6 months	20% (2002)	Must be for a specific, legitimate reason.	Yes
Spain	Tenant has right to annually extend contract for up to 5 years.	1 month before annual renewal date, though acquiring an eviction order can take many months.	10% (2001)	Specific reason required, and then court order must be sought.	Yes, though it is a lengthy process.
Italy	3 or 4 years	6 months	16% (2001)	Must be a specific, legitimate and sufficient reason.	Yes
Ireland	After the first 6 months tenancy is extended for a further 3½ years.	First 6 months – 28 days Then a sliding scale up to 112 days after 4 years.	11% (2006)	No reason in the first 6 months. For the next 3½ years only for specific reasons such as a breach of contract.	Private Residential Tenancies Board provides an informal, cheap and speedy forum for resolving disputes.
United Kingdom	6 months	2 months, but can be served 2 months before initial contract period ends.	12% (2006)	None	No, Section 21 Notices are mandatory with no scope for judicial discretion.

Source: 'The Tenant's Dilemma', Debbie Crewe, June 2007, Crosby, Formby and District Citizen's Advice Bureaux