Challenges and opportunities for the private rented sector

An assessment of the private rented sector and its role in meeting housing need in the UK

A report for National Residential Landlords Association

CAPITAL ECONOMICS

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Key findings

Capital Economics has been commissioned by the National Residential Landlords Association to research and report upon the potential impacts of a range of government policies on private rented sector supply and government revenues.

The key findings are:

The private rented sector is an important component of housing supply in the UK

- The private rented sector has grown in importance since the turn of the century, with the number of homes in the sector more than doubling since 2001 and currently accounting for nineteen per cent of total dwelling stock in the UK
- The majority of private rented sector homes are provided by private individual investors; individuals or groups of individuals comprise 94% of landlords and 83% of tenancies

Over the past five years a range of policies have been introduced which make the private rented sector less attractive to current and prospective landlords

- There have been a range of policies introduced by the government since 2016 that negatively affect landlords including the withdrawal of mortgage interest rate relief, a stamp duty surcharge on the purchase of additional properties and a ban on lettings agent fees
- Potential future reforms to the sector, including the removal of Section 21 evictions and an increase in minimum energy efficiency standards, add further uncertainty
- Government policies and the rise in short-term lets have already weighed on supply in the sector, which fell for the first time since 1998 in 2017; between 2016 and 2020 the annual average net addition to the stock of private rented sector dwellings was 5,000 compared to 205,000 in the previous ten years

More homes are needed to tackle the housing shortage and investment by private landlords is required to achieve this

- Housing supply needs to meet the demand of a projected 1.8 million additional households over the next ten years as well as tackling existing shortages which contribute to 150,000 homeless households, 829,000 overcrowded households and 4.2 million households living in non-decent homes in England alone
- The government has a target of delivering 300,000 new homes annually by the middle of the 2020s, which is consistent with around 340,000 for the UK as a whole

Key findings

- With constraints on the increase in owner occupation and social housing, investment in the private rented sector remains an important component of housing supply
- If owner occupation and social housing continue at their ten-year average rate of growth, private rented sector supply would have to increase by 227,000 per year to meet government targets; even if the other tenures doubled their rate of growth, 105,000 homes for private rental would be needed each year, which is well above current rates of growth

1. Overview of the private rented Sector

The private rented sector has grown in importance over past two decades and now accounts for around one fifth of total dwelling stock

Rising demand for rentals amidst pressure on owner-occupiers

Increasing house price to income ratios and tighter lending conditions have made it more difficult, particularly for first time buyers, to purchase a property. The average house price to earnings ratio has continued to climb in the UK from 4.0 in 2000, and was 6.2 in 2010, and up to 7.1 by 2020.[1]

As a result, although the number of owner-occupiers has been on the rise since 2016 in absolute numbers, it has continued to decline as a share of total dwellings. In 2005, 71% of the dwelling stock was owner-occupied, compared to 64% in 2020.

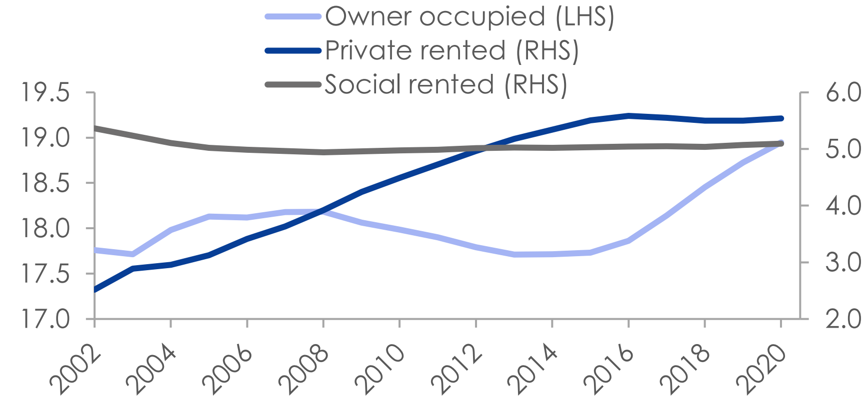
These pressures in the owner occupier market have meant that renting has become a necessity for many.

Buy-to-let mortgages has enabled supply of private rentals

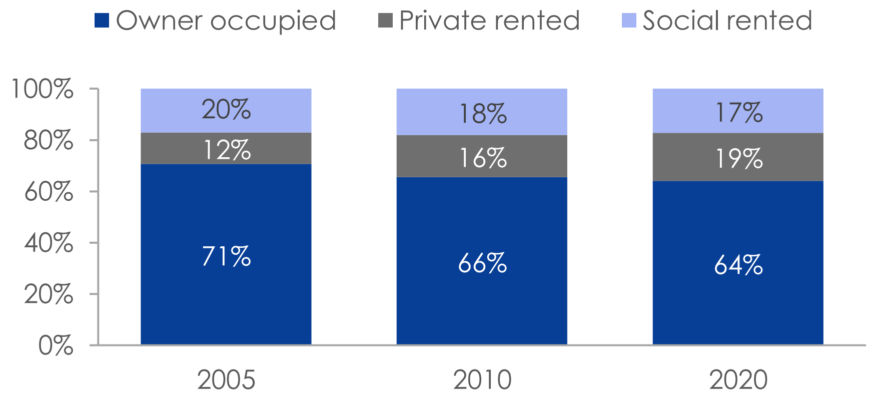
The introduction of buy-to-let mortgages in the mid to late nineties has been an important factor in the rise of private rented sector supply. Around nine per cent of total housing mortgage balances were attributable to buy-to-let mortgages in 2007. By 2016, the share had risen to almost sixteen per cent, and remained there in 2020.

Over the past two decades, the private rented sector's share of the dwelling stock in the United Kingdom has increased considerably, from twelve per cent in 2005 (3.1 million dwellings) to 19% in 2020 (5.5 million dwellings).

Dwelling stock by type of tenure, millions, United Kingdom



Dwelling stock by type of tenure, United Kingdom (share of total stock, %)



[1] Capital Economics analysis of statistics from Nationwide House Prices and the ONS.

Sources: Capital Economics, ONS and MHCLG. *Data for Scotland only available up to 2018 so Capital Economics has estimated the figure for 2019 and 2020

London has the largest private rented stock, with just over one million dwellings

London and the South East regions are the largest PRS markets

London has the largest private rented sector of any region with just over one million dwellings, accounting for around one-fifth of the private rented dwellings stock in the United Kingdom in 2020. The next largest regional markets are the South East and North West which have a total of 670,000 and 556,000 private rented sector dwellings respectively. Meanwhile, the North East and Wales have the smallest stock of properties in the sector.

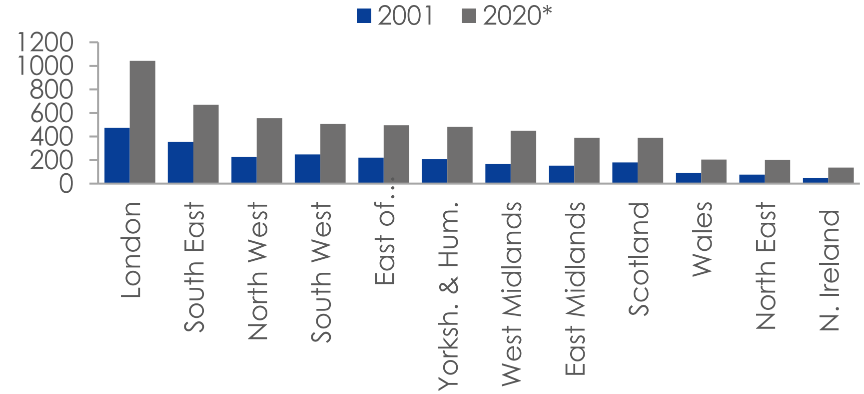
All regions have seen a rise in private rented dwellings stock

There are over twice as many private rented sector dwellings in London in 2020 as there were in 2001, but the capital's share of the total stock is broadly unchanged. All regions have seen a rise in the number of dwellings in the private rented sector over the past two decades. The West Midlands and Scotland saw the largest proportionate rise, growing at a compound annual growth rate of 5.3% between 2001 and 2020. The smallest compound annual growth rate was in the South East, at 3.4%.

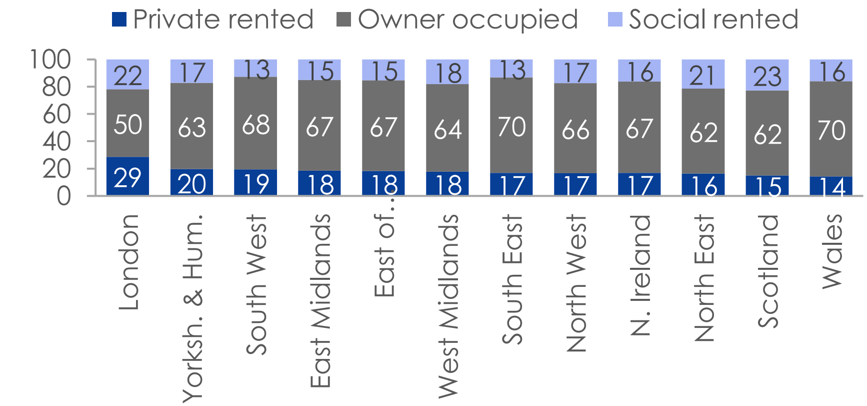
Almost a third of London's dwellings are private rentals

The private rented dwellings stock in London as a share of the stock of all dwellings in the capital is the highest of any region in the United Kingdom at 29%. In part, this reflects the high price of property in the region, holding back first-time-buyers. In contrast, this figure is only sixteen per cent in the North East of England, fifteen per cent in Scotland, and fourteen per cent in Wales.

Number of dwellings in the private rented sector by region, 2001 and 2020* (thousands)



Dwelling stock by type of tenure by region, 2020* (share of total regional stock)



Sources: Capital Economics, ONS and MHCLG. *Data for Scotland only available up to 2018 so Capital Economics has estimated the figure for 2019 and 2020

Landlords in England are mostly private individuals who own under five properties

There are up to 2.6 million landlords in the United Kingdom

Data from the *2018 English Private Landlord Survey* suggests that there were approximately 1.5 million landlords operating in England in 2018 with around 3.4 million live deposits registered with one of the government-backed Tenancy Deposit Protection schemes. However, it is estimated that this only covers somewhere between 56% and 71% of all landlords. Scaling up assuming it covers 71%, and using dwelling stock numbers to scale up to the UK from the England figure, would suggest a total of 2.3 million landlords. Meanwhile, the government estimates that there were 2.65 million individuals who declared income from property, excluding furnished holiday lettings, on their Self-Assessment tax returns in the 2019/20 tax year.

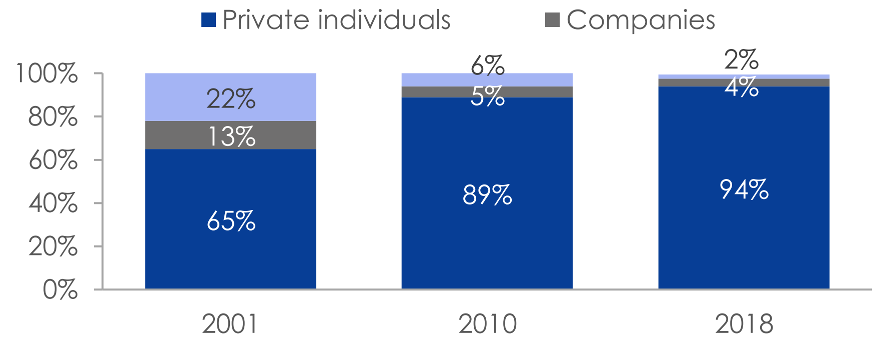
There are not any more recent data, but these figures are unlikely to have changed substantially given that the stock of private sector dwellings in England over the following few years has been relatively stable. (See slide 16.)

The majority of private rented sector landlords are private individuals

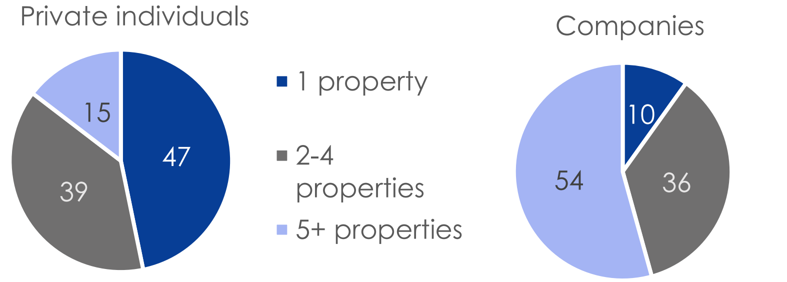
Most landlords that invest in private rental properties are private individuals. This has increasingly been the case over the past two decades. In 2018, 94% of landlords were private individuals, having risen from 65% in 2001.

Private individuals' property portfolios tend to be smaller than companies. Findings from the survey suggest that 86% of private individual landlords owned between one and four properties and only fifteen per cent owned five or more. In contrast, amongst landlords operating as companies, only 46% owned between one and four properties, whereas 54% owned five or more.

Share of landlords by type, England (% of landlords)



Share of landlords by portfolio size, England, 2018 (% of landlords)



Sources: Capital Economics and the 2018 English Private Landlords Survey

2. Challenges for private landlords

There have been growing pressures on landlords from a range of government policies

More housing is needed in the UK

There is a consensus that the UK faces a long-term under-supply of housing, with the shortfall in social housing especially acute. Estimates provided by the Government of the annual number of additional homes required per year in England alone are as high as 340,000, of which 145,000 should be affordable homes.[2] For many years government policy has recognised the need to tackle the housing supply shortage but housebuilding remains well below that level. (See section 2.)

Government policy has focused on promoting home ownership. In its manifesto, the Conservative Government elected in 2019, referred to a need to rebalance the housing market towards home ownership. However, it has so far done little to increase the share of stock that is owner occupied.

A range of policies have been introduced affecting landlords in the private rented sector

Meanwhile, the private rented sector has come under increasing pressure from a range of government policies which make the sector less attractive to many prospective investors and current landlords.

These policies include tax changes for Buy to Let landlords; changes to the Stamp Duty Land Tax which disincentivises the purchase of additional properties; the reduction in Capital Gains Tax on assets excluding property to incentivise investment into assets away from the rental sector; and a ban on letting agents' fees to tenants, a cost which could be passed on to landlords.

Policy announcements which have impacted the private rented sector

Announced	Policy	Effective
Summer Budget 2015	Withdrawal of mortgage tax relief for higher rate income tax payers	Gradual from 6 April 2017
Autumn Statement 2015	Higher rate of stamp duty on purchases of additional properties such as buy-to-let properties and second homes (three percentage points on top of the current rates). Later, a "stamp duty holiday" placing a temporary 0% threshold on tax rate on properties up to £500,000.	1 April 2016. Holiday 8 Jul. 2020 until 30 Sep. 2021
March Budget 2016	Maintained the capital gains tax rates for residential property at 18% and 28% but reduced the rate to 10% and 20% for other assets.	6 April 2016
Autumn Statement 2016	Ban on letting agents' fees to tenants	June 2019
15 April 2019	Consultation to remove Section 21 of the Housing Act 1988, which enables private landlords to repossess their properties without having to establish fault on the part of the tenant.	Consultation ongoing
Autumn Budget 2021	After reducing the window for which capital gains tax must be paid to 30 days, this was increased to 60 days.	27 October 2021

Sources: Capital Economics and UK Government Website

[2] House of Commons Library, Tackling the under-supply of housing in England, (United Kingdom), March 2020

Landlords’ bottom line has been hit by the removal of mortgage interest tax relief

Removal of mortgage tax relief hits landlords’ bottom line

In 2015, the then chancellor, George Osborne, announced that the tax relief that landlords had enjoyed on mortgage interest payments would be restricted to the basic rate of income tax.

Previously, buy-to-let landlords paid no tax on mortgage interest, which was seen as a business expense. Starting in April 2017, one quarter of the relief was withdrawn each year until all financing costs incurred by a landlord were given as a basic rate tax reduction in 2020/21. Now, higher-rate taxpayers essentially pay 20% tax on the amount of their mortgage interest rate, and 25% for additional rate taxpayers.

The policy makes returns on buy-to-let investments less attractive. Using an exemplar property and mortgage (see assumptions in the top table), a landlord who is a higher-rate taxpayer, with a property of £200,000, a mortgage of £122,000 and facing an interest rate of 3.5%, would pay £4,270 on mortgage interest payments. With only the basic relief, this landlord would pay £854 additional tax per annum.

One quarter of landlords would postpone investments as a result

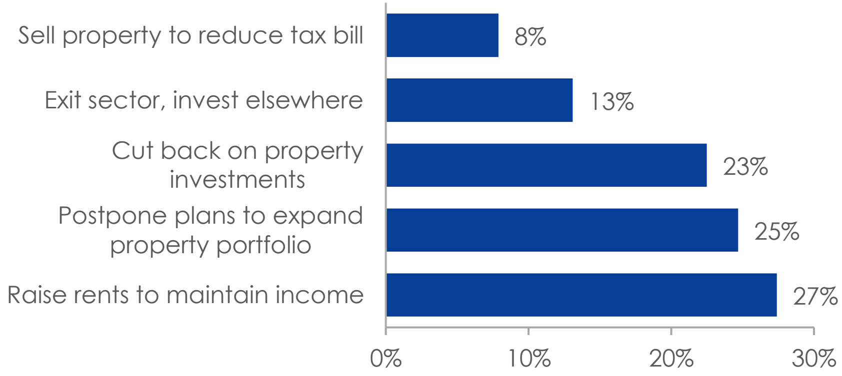
With investment yields taking a hit from the policy, landlords are disincentivised to increase their property portfolios. A survey conducted by the NRLA in 2019 asked landlords of their planned reaction to the removal of mortgage tax relief.

It was found that nearly quarter of would cut back their property planned investments. Over one in ten landlords agreed that they would exit the property sector and invest elsewhere instead.

Exemplar impact of withdrawal of mortgage interest relief for higher rate tax payer with one property

Assumptions	Outcomes
House price: £200,000 Gross rental yield: 4.8% Rent: £9,600 Loan-to-value ratio: 61% Mortgage: £122,000 Interest rate: 3.5%	• Mortgage interest payment: £4,270 • Allowable expenses (10% rent): £960 • Pre-tax income: £4,370
	With relief (old policy): • Tax paid: £1,748 (at 40%) • **Net profit: £2,622** • **Yield after cost: 1.31**
	With only basic relief (new policy): • Tax paid: £1,748 (at 40%) plus £854 (at 20%) • **Net profit: £1,768** • **Yield after cost: 0.88**

Landlords’ intended response to the removal of mortgage interest rate relief (% of respondents*)



Sources: Capital Economics, and NRLA quarterly report Quarter 3, 2019 “State of the Private Rented Sector Supply: Finance, Tax & Supply”. *Note: respondents could provide more than one answer, n=1,980 landlords..

Lower returns for landlords from the ban on agents charging tenants fees

Tenant Fee Act reduces income for some landlords

In the 2016 Autumn Budget, Philip Hammond announced the government's intention to put a ban on fees charged by letting agents. These fees are the result of services offered to potential landlords by residential letting agents and accounted for around a fifth of agents' revenues. The average total fee charged to tenants in the United Kingdom before getting the keys was £412.

A study by Capital Economics conducted in 2017 – around the time of the policy – assessed its potential impact. It found that in the most plausible scenario (bottom row in bottom table), whereby letting agents pass on 75% of the loss in fees to landlords and landlords pass on 50% of their increase in costs to tenants, agents lose £0.2 billion in turnover, landlords lose £0.3 billion in income, and tenants pay an increased rent of £103 per annum.

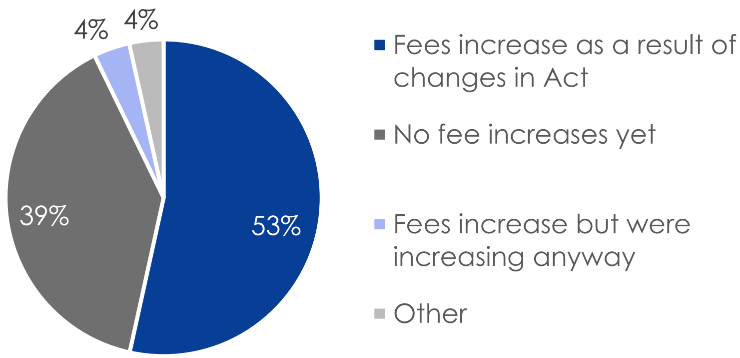
Over half of landlords reported seeing their agency fees rise

According to a survey of landlords who reported using a letting agent and/ or management agent, conducted by the NRLA, over half reported seeing the fees they pay rise as a result of changes in the Tenant Fee Act. This compared to only four per cent who stated seeing a rise in fees, but because these fees had been increasing anyway.

Indicative impact of different outcomes of letting fees ban

Assumption	Estimated outcome
Letting agents do not pass on loss in fees to landlords	• Letting agents lose £0.7 billion • 16,000 jobs at risk in lettings sector • Landlords' income does not change • Tenants' rent does not change
Letting agents pass on 75% of loss in fees to landlords	• Letting agents lose £0.2 billion • 4,000 jobs at risk in lettings sector • Landlords lose £0.5 billion of income • Tenants' rent does not change
Letting agents pass on 75% of loss in fees to landlords, landlords pass 50% of their increase in costs to tenants	• Letting agents lose £0.2 billion • 4,000 jobs at risk in lettings sector • Landlords lose £0.3 billion of income • Tenants' annual gross rent rises £103

Changes to landlords' agency fees since the Tenant Fee Act (% of respondents who use lettings and management agents)



Source: Capital Economics and NRLA quarterly report Quarter 2, 2019 "State of the Private Rented Sector Supply: Regulation & Enforcement". n=1,220

An additional Stamp Duty levy increases the cost of investing in new properties

Stamp duty levy deterred entry to the buy-to-let sector

Effective as of April 2016, as part of the government's stated commitment to support first-time buyers, an additional three per cent levy on top of the Stamp Duty Land Tax was introduced on purchases of additional residential properties. In Scotland this was increased to four per cent. This made it more expensive for potential investors to purchases properties for the private rented sector.

The policy initially distorted the market. Buy-to-let mortgage surged upon announcement of the policy. Buyers looked to purchase any additional property sharply before they incurred additional tax costs and applied for buy-to-let mortgages to do so. Following the implementation of the tax levy, advances fell sharply. In the years that followed, the level of advances settled a little below that of the years leading up to the surcharge announcement.

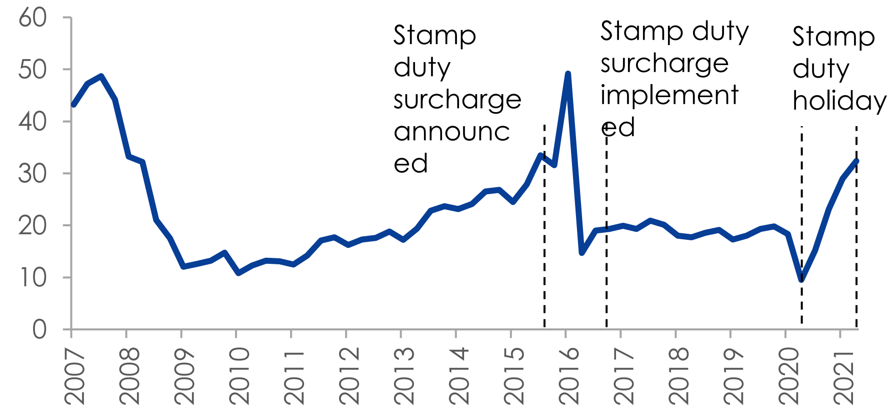
Similarly, between March 2020 and September 2021, the stamp duty holiday which removed the additional rate on properties up to £500,000 led to a surge in buy to let mortgage advances. The impact of the end of this holiday period is not yet shown in the data.

Surcharge had a significant impact on over 25% of landlords

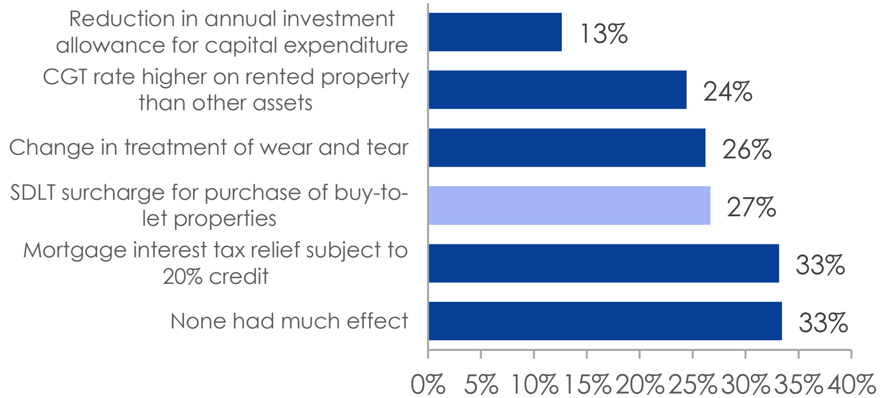
Not only can the effects of the policy be seen in the mortgage application data, but landlords reported seeing a significant impact from this policy.

When asked in a survey conducted by LSE and the NRLA, over a quarter of landlords selected this Stamp Duty surcharge as having a significant impact on the operation of their business. This closely followed the Mortgage interest tax relief, which saw a third of landlords select this policy.

Buy to let mortgage advances for house purchases (thousands)



Share of landlords for which recent tax changes have had a "significant impact" on operation of their landlord business (% of respondents)



Sources: Capital Economics, Bank of England, and Survey results from LSE for the NRLA "Private landlords and tax changes", 2021. *Note: respondents could provide more than one answer, n=1,384 landlords.

Elevated capital gains tax increases the cost of selling properties and reduces profits

Capital Gains Tax rates favour assets other than property

Capital Gains Tax is paid on the profit made from the disposal (sale or gifting) of assets and influences landlords' investment behaviour.

Prior to 6 April 2017, top rate taxpayers faced a capital gains tax rate of 28% for all assets, while the lower rate was 18%. Following the policy reform, all assets aside from property had the rates reduced to 20% and 10% respectively. The policy objective was to "create a strong enterprise and investment culture" and to "provide an incentive for individuals to invest in companies over property".

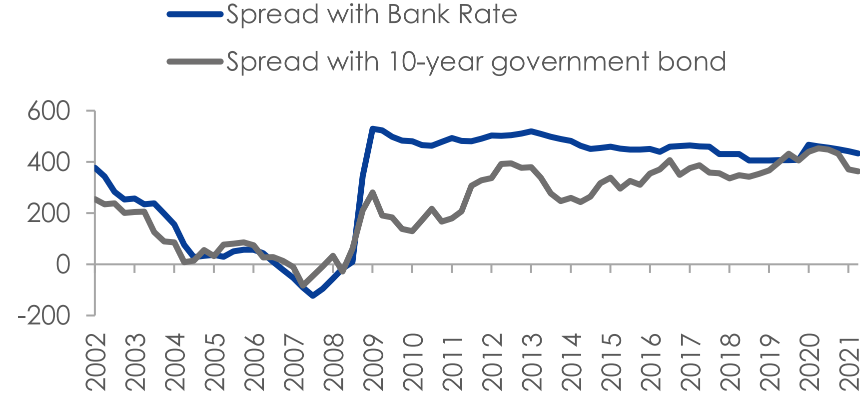
What's more, when the spread between rental yields and other assets falls, as it has done over the past year or so, landlords are even more likely to shift their future investments away from property.

Higher rates of Capital Gains Tax discourages sales

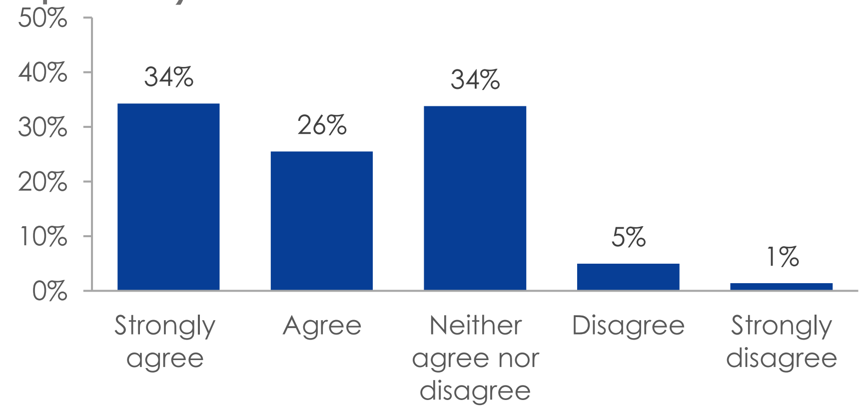
Not only can a higher Capital Gains Tax rate disincentivise future investments, but it could lead to a fall in transactions, as landlords seek to avoid this tax cost.

A survey conducted by the NRLA found that in 2020, 60% of landlords who had considered selling property, held on for longer because of the Capital Gains Tax liability they would have incurred.

Spread of gross rental yield with Bank Rate and 10-year government bond (basis points)



Share of landlords that agree that they held property longer than envisaged as a result of Capital Gains Tax (% of respondents)



Sources: Capital Economics, ONS, Nationwide House prices, Refinitiv, and NRLA quarterly report Quarter 3, 2020 "In Focus: Landlords and Taxation", survey sample n=1,468.

Potential future reforms to the rental market add uncertainty

Removal of Section 21 threatens ease of business for landlords

In 2019, the government proposed that Section 21 of the Housing Act 1988, which enables private landlords to repossess their properties without having to establish fault on the part of a tenant, would be removed. Without these powers, it becomes more difficult and expensive for landlords to remove problematic tenants. In 2019, a study by Capital Economics for the National Landlords Association found that sixteen per cent of landlords had seen their most recent tenancy end because they served a section 21 notice. Removal of section 21 would affect ease of business, encouraging some landlords to exit the market or move to more flexible short-term tenancies. A White Paper detailing this matter is expected in 2022.

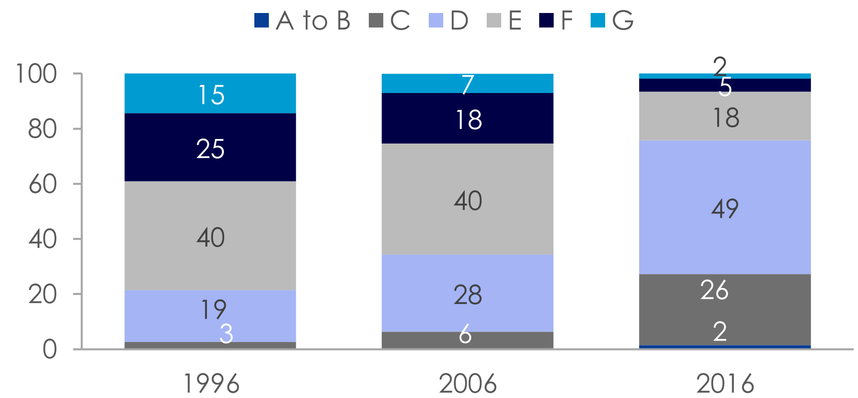
Environmental regulations could lead to additional costs

As of April 2018, all new lettings were required to have a minimum energy efficiency EPC rating of E. Data from the Office for National Statistics suggests that, in 1996, 40% of private rented dwellings in England had EPC rating of F and G (poorer than E). By 2016, before the requirement came into place, only 7% failed to meet E standard. The policy is therefore unlikely to have had much impact on landlords' behaviour.

However, as part of the government's pledge to net zero emissions by 2050, an increase to the minimum standard to Category C by 2035 has been proposed. Estimates from a report by National Residential Landlords Association suggest the average costs of retrofitting a property to meet the higher EPC-C target at £18,000 per property. The study found that 55% of the over one thousand landlords they surveyed have funded energy efficiency improvements from their savings, and 52% did so from their rental income or profits. The risk of future costs associated with such energy upgrades could shift investor sentiment away from property.

Share of most recent tenancies by how they ended, 2019, % of respondents

Energy efficiency ratio band for the private rented dwellings in England, 1996 to 2016



Sources: Capital Economics, National Landlords Association, National Residential Landlords Association, and ONS.

The rise of short-term letting has put further pressure on the number of homes available for long term tenants

Short-term lets have become attractive alternative for some landlords

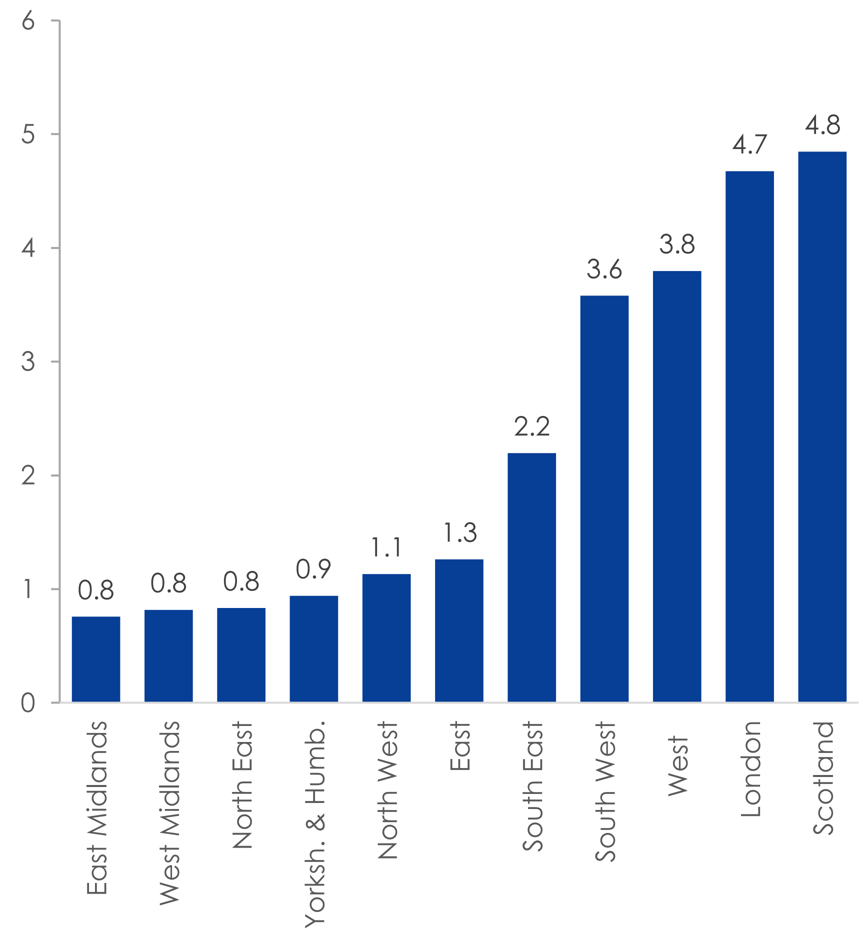
There have been growing concerns that the short-term letting industry is having a negative impact on the private rented sector by reducing the supply of much needed properties to live in.

Using estimates of Airbnb exposure by region as a proxy for short-term letting in the UK, we see that the South West, Wales, London and Scotland are the most heavily exposed. Meanwhile, many regions have small exposure to short-term letting.

Short-term letting has increased in popularity over the past decade. It has been an attractive alternative over long-term lettings for many landlords who favour increased flexibility and have been put off by more burdensome regulations in the private rented sector. Without long-term tenants, landlords can more easily sell-up and leave.

It is likely that many properties will have been switched back to the longer-term letting market during COVID-19. Landlords with short-let properties have been heavily affected by the drop in tourism due to the pandemic.

Regional estimate of entire home Airbnbs as a share of private rented dwellings, United Kingdom, 2018 (%)



Sources: Capital Economics and AirBnB

Mounting policy pressures and the shift to short-term rentals have taken their toll on supply in private rented sector

Supply falls in England following 2016 policy reforms

Government policies and the shift to short-term lets have already weighed on supply in the sector. Although not yet available for the UK, dwellings data has been released for England up to 2020.

In 2016, the first of previously outlined policies came into force. In the years that followed, the number of dwellings in the private rented sector in England fell, totalling a loss of around 70,000 dwellings between 2017 and 2019. These were the first falls seen since the large-scale take-up of buy-to-let mortgages began around the turn of the century.

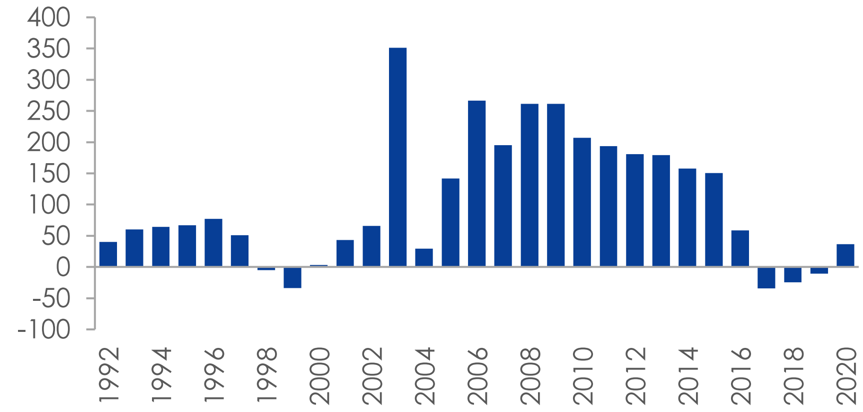
Although there was a small annual rise of 36,000 in 2020, this was likely bolstered by a number of transitory factors including the stamp duty holiday, the slump in short-term lets, the COVID-19 buy-to-let three-month mortgage payment holiday, and the policy preventing the eviction of tenants in arrears due to COVID-19.

Growth in dwellings has fallen in all regions

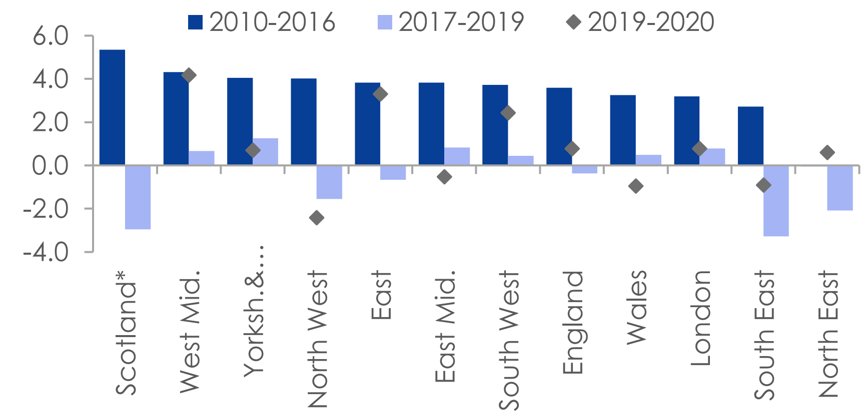
The slowdown in supply following policy pressures on landlords has been evident across the country. In the period before the policy reforms between 2010 and 2016, the compound annual growth rate far exceeded that seen between 2017 and 2019, with many regions seeing falls in recent years.

The effect of COVID-19 on supply in 2020 appears to have been more mixed. Some regions, such as the West Midlands and the South West saw private rental supply growth rise, and rates were higher than in previous years. In contrast, the North West, East Midlands, South East, and Wales saw further contractions in the annual growth of private rented dwellings in 2020.

Annual change in private rented sector dwelling, England, (thousand dwellings)



Growth in number of dwellings in the private rented sector in England, by region (CAGR, per cent)



Sources: Department for levelling up, Housing and Communities. *Note: Scotland up to 2018.

3. Meeting the UK's housing need

There is a shortage of housing in the UK that needs to be addressed

Well recognised shortage of housing in the UK

It is widely recognised that there is an under supply of housing in the UK. A House of Commons briefing paper stated that *'There is consensus around the long-term under-supply housing and the need to address this, but there is less agreement within the industry about how best to achieve the necessary step-change in supply*'.

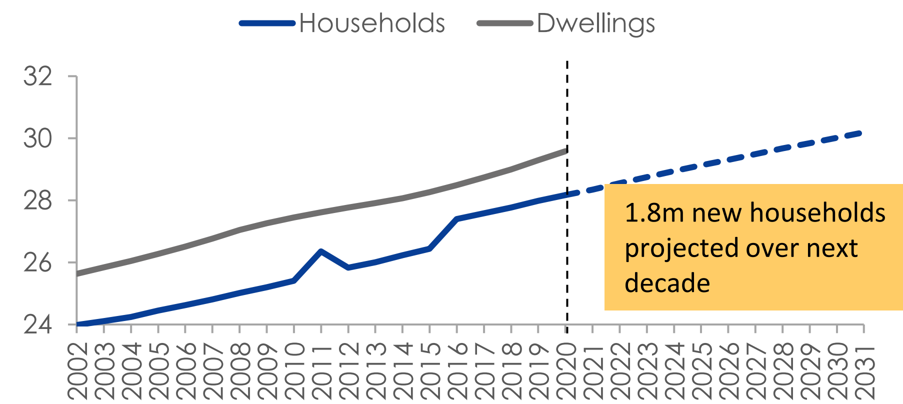
Household growth one of many factors

Over the next ten years the number of households in the UK is expected to increase by 1.8 million, increasing demand for places for people to live. There were 29.6 million dwellings in 2020 compared to 28.2 million households, however the ratio of dwellings to households has fallen from 1.07 in 2002 to 1.05 in 2020. Comparing the number of dwellings to households is only one metric to assess housing need and it is far from perfect given that household formation itself is constrained by the number of dwellings.

There are a range of factors which suggest there is a shortage of good quality affordable housing. In 2020/21, there were 150,000 people in England classified as homeless. In addition, there are 829,000 households that are living in overcrowded environments and a further 4.2 million households living in poor quality accommodation classified as 'non-decent homes'. There has also been a sharp increase in young people living at home. Between 2000 and 2020, the share of people aged between 20 and 34 that were living with their parents increased from 20% to 28%.

Under-supply is not the only issue impacting the UK's housing market, which is constrained for example by the availability o mortgage credit, but it is clear that more good quality places for people to live are needed to meet future demand and address existing problems

Households and dwelling stock, UK (millions)



Range of metrics indicative of housing shortage

Homeless households, England 2020/21	150,000
Overcrowded households, England 2019/20	829,000
Households in 'non-decent' homes, England 2019	4.2 million
Population aged 20 to 34 living with parents, UK 2020	3.7 million

Sources: Capital Economics, ONS and MHCLG, Note that data on dwellings is only available for the devolved nations up to 2018. We have projected it forward using growth in England

Government estimates that 300,000 new homes are needed each year in England

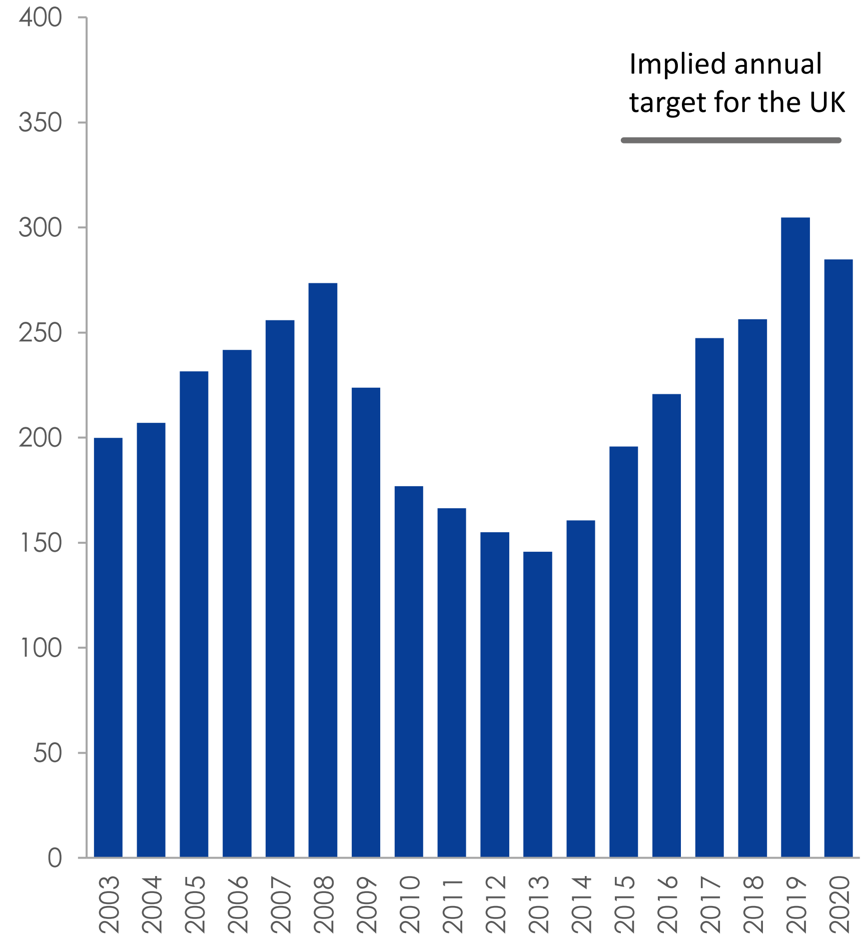
In its 2019 manifesto, the now government pledged to reach their target of 300,000 more homes annually by the mid-2020s, with at least one million over the course of this parliament.

The calculation of housing need is based on the ‘standard method’ which is a simple formula based on projections of household growth, An adjustment for affordability, based on the ratio of earnings to house prices, is then applied to each local area. Although not explicitly including the need to address the number of people that are homeless, or in overcrowded or non-decent homes, it does implicitly account for some of the existing shortage by assuming additional supply that is needed to reduce prices.

This is a fairly broad measure but does provide a consistent measure of housing need across different areas of the country.

We have not found official housing targets for the devolved nations, although Scotland has announced a target of specifically for affordable homes, aiming to deliver 100,000 more over the next decade. Comparing household projections in the devolved nations to England suggests that the annual target of 300,000 new homes in England is consistent with around 340,000 for the UK as a whole. This is more than has been delivered in any of the past seventeen years and is over 50% higher than the average over the same period.

Annual change in dwelling stock, UK (thousands)



Sources: Capital Economics, ONS and MHCLG, Note that data on dwellings is only available for the devolved nations up to 2018. We have projected it forward using growth in England

There are limits to growth in owner occupation and social housing

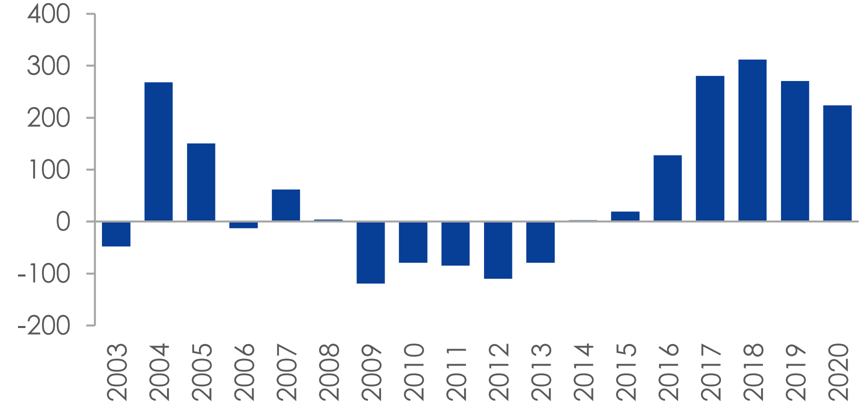
A number of factors will constrain owner occupation

There are a number of reasons that owner occupation is unlikely to increase sufficiently to address issues in the housing market. First, it is unlikely that the government will hit its target for housebuilding, keeping prices high and constraining prospective buyers. Housebuilding will be limited by labour and material shortages in the short term, softening demand in the medium term, the withdrawal of the Help-to-Buy equity loan scheme in 2023 and faltering political support for proposed planning reforms following a shock by-election defeat in June 2021 in Chesham and Amersham, which was in part due to concerns over more housebuilding in the area. Second, interest rates are set to rise, which will put upward pressure on mortgage rates and reduce affordability. Third, banks are unlikely to significantly reduce lending standards that were tightened after the global financial crisis.

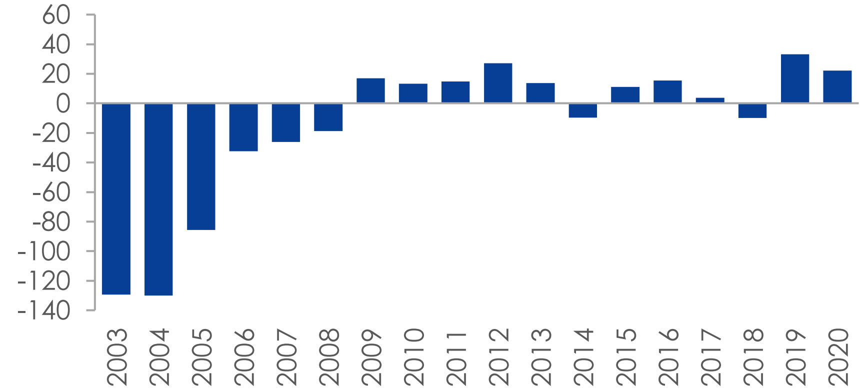
Levels of investment in social housing remain relatively low

Social rent housing and affordable housing provided by housing associations has averaged just 12,000 net additions to the stock per year over the past decade. This number includes Right to Buy sales, conversions and demolitions. In the March 2020 Budget, the government announced an additional £9.5 billion in funding for the Affordable Homes Programme, bringing the total programme to £12.2 billion available from 2021 for five years. This is expected to deliver 180,000 affordable homes by 2026, around 32,000 of which will be for social rent. This is equivalent to 30,000 gross additions per year if the target is met.

Annual change in owner occupied dwelling stock, UK (thousands)



Annual change in rented dwelling stock from private registered providers and local authorities, UK (thousands)



Sources: Capital Economics, ONS and MHCLG, Note that data on dwellings is only available for the devolved nations up to 2018. We have projected it forward using growth in England

Private rented sector has key role to play

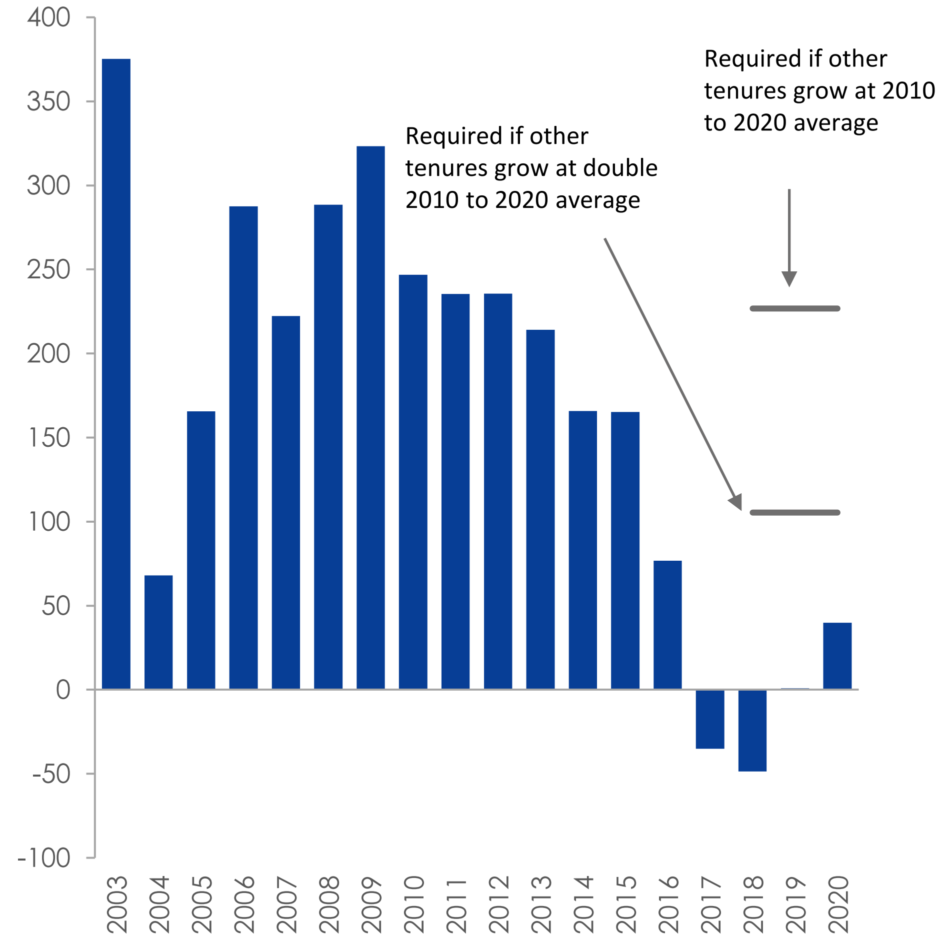
PRS sector needs to grow to meet housing need

In order to meet the targets of providing 340,000 new homes per year requires a mixed approach which includes increased housing for owner occupation and more social and affordable housing. But investment in the private rented sector is critical to continue to provide rental homes for households across the country. We have developed an indicative model to illustrate the increase in private rented sector stock needed in order to meet the governments housing targets under different scenarios. If the stock of owner-occupied properties and social housing continues to grow at the same pace as the past ten years, over 225,000 more private rented sector dwellings would be needed each year. This compares to an average of 105,000 over the past decade and an average fall of 11,000 annually since 2016. Even if owner occupation and social housing provision increased at twice the rate it has done over the past decade, 105,000 additional private rented sector dwellings would be needed each year, which is well above current levels.

Investment in PRS sector is critical to providing homes

In order to meet the need for supply of PRS investment in the sector is needed. Increased investment will support a combination of an increased rate of new builds, switching of commercial property to residential use, switching stock from short term to long term lets and bringing empty homes back into use.

Annual change in private rented sector dwelling, UK (thousand dwellings)



Sources: Capital Economics, ONS and MHCLG

Private rented sector has key role to play

PRS stock needed to meet demand across the country

Regardless of whether the government reaches its housebuilding target, more PRS stock will be needed to meet demand and improve the functioning of the housing market. It will help to meet demand for homes for those who cannot afford home ownership, those currently loving with parents, people living in overcrowded households, dwellings in poor condition or those that are homeless. In addition, there are mismatches in the location and suitability of supply and demand; more PRS stock will help to redress these imbalances and put downward pressure on rents. Some people will choose to rent rather than buy for reasons including sharing with others in a multiple occupancy household, geographical flexibility, less commitment and proximity to jobs or social activities.

There are significant differences between regions

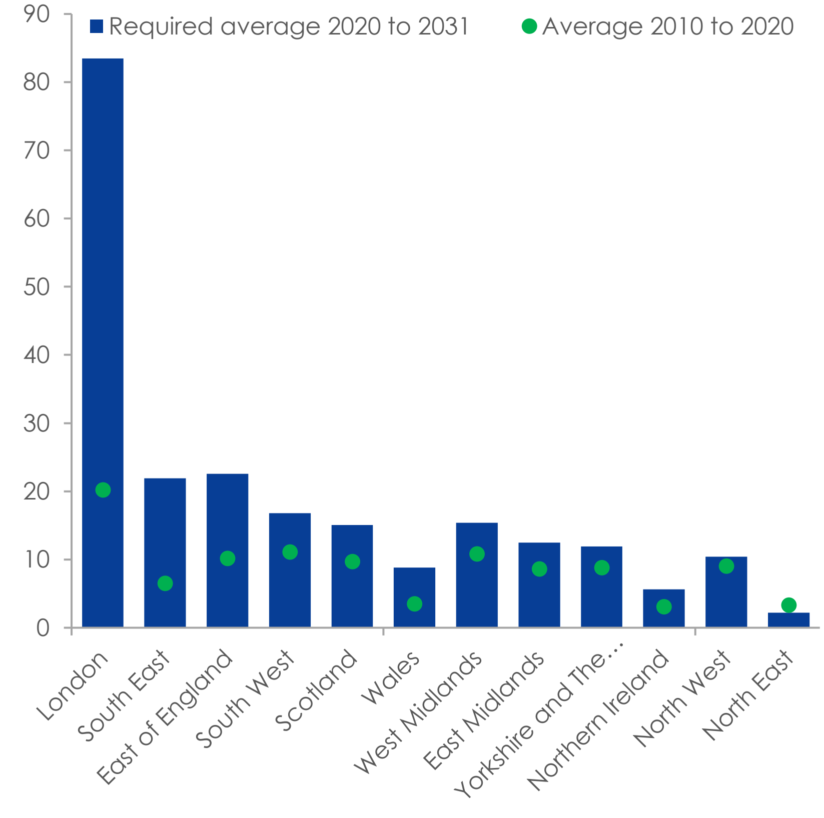
The severity of the housing shortage varies considerably by region. It is most acute in London, where over 80,000 extra PRS homes are needed per year to meet targets based on housing need, four times the average increase over the past decade. However, the required annual average increase is higher than the average for the past ten years in all regions apart from the North East.

Build to rent is still a small part of the picture

Some of the demand can be met through build to rent schemes. However, this remains a small (albeit growing) sector with a total of just 69,000 completed homes across the UK. Private individual landlords remain the largest providers of private rental accommodation by some distance.[3]

[3] British Property Federation.

Average annual change in PRS dwellings required to meet housing targets if owner occupied and social housing dwellings increase at their average rate between 2010 and 2020, UK (thousands dwellings)



Sources: Capital Economics, ONS and MHCLG

4. Modelling impacts of potential policies

We developed a model to estimate the impact of each policy on PRS supply and tax revenues over the next ten years

- English Private Landlord Survey
- Official statistics including MHCLG dwelling stocks

Stage 1:

Segment the number of landlords in the private rented sector by region and portfolio size

- Number of landlords and PRS dwelling stock by region and portfolio size

- Results from survey of private landlords by portfolio size
- Range of assumptions

Stage 2:

Estimate the change in private rented sector supply over the next ten years under policy scenario

- Increase in stock from PRS investment
- Decrease in stock from PRS investment
- Net change in PRS stock

- Exemplar landlord portfolios and profits
- Official tax revenue statistics
- Survey of private landlords
- Range of assumptions

Stage 3:

Estimate the change in overall tax revenues for the exchequer over ten years

- Change in income tax from landlords
- Change in corporation tax from landlords
- Stamp duty from purchases
- Capital gains tax from sales

Our base case shows landlords are cautious about their activity in the next decade

Only 42% plan to keep their portfolios the same size

To understand the potential impacts of the range of policies on landlords' behaviour, we established a baseline of landlords' expected actions over the next five years. Results from our survey suggest that 22% of landlords plan to increase the size of their property portfolio. Meanwhile, 42% plan to keep their portfolio the same size, 26% plan to reduce their portfolio size, and ten percent plan to leave the market entirely.

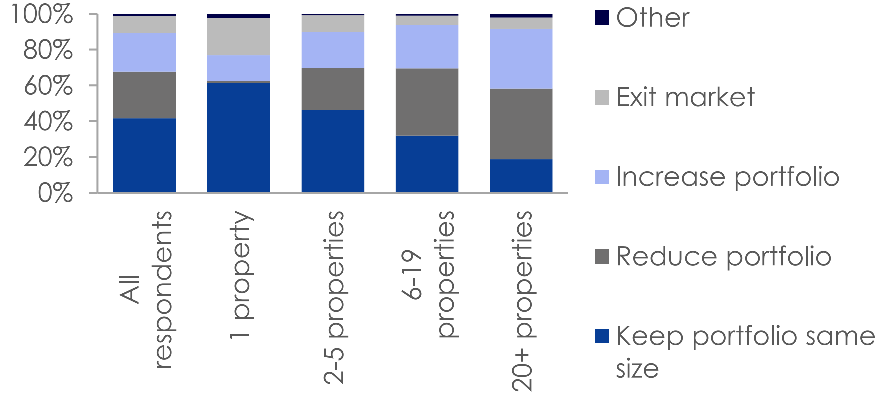
Those with larger current portfolios tend to be more inclined to increase the size of their portfolio. Of those holding more than 20 properties, 33% intend to increase their investments, compared to only fourteen per cent of those who currently hold only one property. Similarly, those with smaller current portfolios are more likely to want to keep their portfolio the same size.

Our model indicates a fall in private rented sector supply

Our modelling of the survey results implies that, given the current state of play with no additional policies implemented, the private rented sector stock will decrease by around 540,000 properties over the next ten years. This includes 680,000 properties that are purchased, and 1,210,000 properties that are sold by landlords. The resulting impact on tax would be an additional £17.1 billion over ten years. There would be a loss of income tax of £7.6 billion and a rise in Capital Gains Tax revenue of £18.7 billion, and £5.9 billion in Stamp Duty Land Tax revenue.

This figure does not account for new entrants as there aren't data to break down the net change in private rented sector stock. However, it provides a consistent basis from which to measure the impact of the policies. As such, the estimates of policy impacts are conservative given the implicit assumption that the level of new entrants is the same in all scenarios, even when the policies are more positive or negative.

Share of survey respondents and their portfolio plans for the next five years, for all respondents and by portfolio size (%)



Base case estimated change in private rented sector supply and fiscal impact over the next ten years in the UK

Base case	
Private rented sector dwellings purchased (000s)	+680
Private rented sector dwellings sold (000s)	-1,210
Net effect on private rented supply (000s)	**-540**
Change in income tax revenue (£ billion)	-7.6
Change in corporate tax revenue (£ billion)	n/a
Change in Capital Gains Tax revenue (£ billion)	+18.7
Change in Stamp Duty Land Tax revenue (£ billion)	+5.9
Net fiscal impact (£ billion, [net present value])	**+17.1 [+16.3]**

Source: Capital Economics' analysis of survey of landlords conducted December 2021. n=608.

Policy modelling: Removal of the 3% Stamp Duty Land Tax levy on additional properties

More than a third of landlords increase their portfolio size

Landlords appear to react positively to the prospect of the removal of the the additional three per cent levy charged on top of the Stamp Duty Land Tax rate when landlords purchase additional properties.

From our survey results, over a third of landlords would increase the size of their portfolio in response to this policy. Of these, around a quarter were planning on reducing the size of their portfolio or leaving the market in the base case.

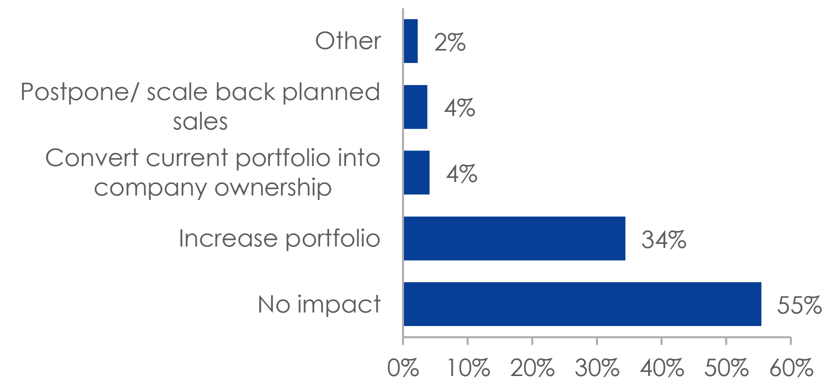
Meanwhile, of the 55% who said the policy would have no impact, the majority of these landlords either had no plans to change their portfolio or were increasing in the base case.

Supply could be 890,000 higher than in the base case

With the Stamp Duty Land Tax additional levy removed, it becomes relatively less costly to purchase new properties, incentivising additional purchases. With this showing up in the survey results, our model predicts that over the next ten years, there would be 890,000 more properties in the private rented sector than in the base case. While landlords increased their purchases of properties by 430,000 more, they also made 460,000 less sales.

The Chancellor of the Exchequer would benefit from this lower tax effective stamp duty rate. According to our model, the net effect on overall tax revenue would be £10.0 billion higher than in the base case. This is mainly because the government receives an additional £10.5 billion over the ten years from income tax revenue. Furthermore, these tax revenue streams would continue over the decades that follow, so long as the landlords do not later sell these properties.

Most likely response to removal of the 3% levy on the Stamp Duty Land Tax rate charged for additional properties (Share of respondents, %)



Estimated impact of policy on private rented sector supply and fiscal impact over the next ten years in the UK

Removal of the 3% Stamp Duty Land Tax levy relative to the base case	
Private rented sector dwellings purchased (000s)	+430 (more purchased)
Private rented sector dwellings sold (000s)	+460 (less sold)
Net effect on private rented supply (000s)	**+890**
Change in income tax revenue (£ billion)	+10.5
Change in corporate tax revenue (£ billion)	+2.0
Change in Capital Gains Tax revenue (£ billion)	-2.7
Change in Stamp Duty Land Tax revenue (£ billion)	+0.2
Net fiscal impact (£ billion, [net present value])	**+10.0 [+7.9]**

Source: Capital Economics' analysis of survey of landlords conducted December 2021. n=608

Appendix

Stage 1: Segmenting the private rental landlord population

Our model considers the behaviour of private individual landlords only					*Company landlords' behaviour is assumed to be constant*				
	Private individual landlord				Company landlord				Total
Portfolio size band	**1**	**2-5**	**6-19**	**20+**	**1**	**2-5**	**6-19**	**20+**	
Average portfolio size	**1**	**3**	**7**	**20**	**1**	**3**	**7**	**20**	
UK	787,742	683,388	177,911	35,174	10,210	40,763	30,132	22,101	1,787,422
London	148,164	128,537	33,463	6,616	1,920	7,667	5,667	4,157	336,192
South East	95,274	82,653	21,518	4,254	1,235	4,930	3,644	2,673	216,182
North East	28,885	25,058	6,524	1,290	374	1,495	1,105	810	65,541
East	70,683	61,319	15,964	3,156	916	3,658	2,704	1,983	160,383
East Midlands	55,554	48,195	12,547	2,481	720	2,875	2,125	1,559	126,055
North West	79,050	68,578	17,853	3,530	1,025	4,091	3,024	2,218	179,368
West Midlands	64,085	55,595	14,473	2,862	831	3,316	2,451	1,798	145,411
South West	71,976	62,441	16,256	3,214	933	3,725	2,753	2,019	163,316
Yorkshire and the Humber	68,579	59,495	15,489	3,062	889	3,549	2,623	1,924	155,610
Scotland	56,875	49,341	12,845	2,540	737	2,943	2,176	1,596	129,052
Wales	32,700	28,368	7,385	1,460	424	1,692	1,251	917	74,198
Northern Ireland	19,471	16,891	4,397	869	252	1,008	745	546	44,180

Note: regions do not sum to UK total due to rounding.

The survey sample was not sufficient to vary by region, but we accounted for:

- Differences in landlord profits based on regional average house prices, rental yields, maintenance costs, share with a Buy-to-let mortgage.
- Stamp Duty Land Tax paid based on regional average house prices.
- Differences in Capital Gains Tax paid based on average house price growth over the last decade.

Stage 2: Estimating the change in private rental supply

We assumed changes in portfolio size for survey responses

To estimate the change in supply, we conducted a survey amongst members of NRLA. This provided information on how private landlords plan to change their portfolio in the base case and how they would change their portfolio in response to each of the six policies. We made assumptions as to how many properties the "average portfolio size" would increase or decrease by for each possible response to the survey question. Assumptions were made by analysing the policy response alongside the respondent's answer to the "base case". (See Table.) For any nonsensical answers, it was assumed that the respondent would act as they did in the base case. We multiplied the portfolio change associated with a response to the question, by the survey results of that response (share of each portfolio band), and the number of private individual landlords in that portfolio band from Stage 1. Summing across all responses and landlord portfolio types gives the estimated change in the supply of the private rented sector stock over the next ten years.

Our representative sample included 608 landlords

To ensure that the survey sample was representative of private individual landlords, we only included respondents who stated that they were a landlord of multiple properties or one property, and excluded those who were lettings agents, a housing officer, or a former landlord. For our results to be comparable across all policies, we excluded respondents who failed to provide the following information: their region, their portfolio size band, a response to our base case or any of the six policies. The final sample size was 608 landlords. Because our estimates for supply required us to scale up by portfolio size, it was important that our sample sizes were sufficient for each portfolio band. There were 91 respondents with one property, 266 with 2-5 properties, 203 with 6-19 properties and 48 with 20+ properties.

Assumptions for the change in the "average portfolio size" over 10 years for the base case and applied to policies

Portfolio size band	1	2-5	6-19	20+
Average portfolio size	**1**	**3**	**7**	**20**
Base case – Assumed change in average portfolio size in next 10 years				
Same size	0	0	0	0
Reduce	-1	-2	-4	-10
Increase	+1	+2	+4	+10
Exit market	-1	-2	-6	-20
Other	0	0	0	0
Any of the six policies – Add to the base case, the following assumed additional change in average portfolio size over the next 10 years				
Additional reduction in portfolio/ less investment due to policy	-1	-1	-2	-4
Additional investment/ less reduction due to policy	+1	+1	+2	+4
Converted to family use	-1	-1	-1	-2

Stage 3: Estimating the tax take for the Chancellor of the Exchequer

The timing of landlords' actions are important for tax revenue

From the point in time that any private individual landlord reduces their portfolio size, the Chancellor of the Exchequer no longer receives income tax on this number of properties for the years that follow. Similarly, for any increase, there is additional income revenue. If a landlord coverts their portfolio into a company structure, this income tax revenue is lost each year, but there is a gain in corporate tax. The top table shows the assumed timings. The new tax rate associated with each policy is applied if the purchase is made after the policy comes into place.

We assumed a share of high- and basic- rate taxpayers

We scaled up the supply changes for each year, from year zero to year ten, using the assumed timings and changes to the example portfolio from Stage 2, the survey results by portfolio size, and the landlord population estimates from Stage 1. The associated change in tax revenue was found by multiplying this change in supply by an example tax revenue for each tax type, paid per property. These calculations included landlord profit estimates for those with, and without a buy-to-let mortgage, informed by statistics from the EPLS. Our example profit per property ranges from around £3,743 for those in the North West with a mortgage, to £15,658 for those in London without a mortgage.

Scaling this up for average portfolio sizes for each band informed our assumptions of the share of private individual landlords facing the high- and basic- tax rate, as shown in the bottom table. Those holding multiple properties are more likely to have greater profits than the average individual. Data published by the UK government suggest that around 70% of UK private landlords are basic-rate taxpayers, which we matched to our sample.

Assumptions of the timings for policy reactions, year 0 to 10

Response	Time
All policies come into place	2
Response given in the base case or with no reference to change in timing due to a policy	3
Response with "in advance of policy"	1
Response with "once three-year threshold is met" (for taper to capital gains tax rate for long-term landlords)	4
Response with "structure future investments in the private rented sector through a limited company rather than as an individual"	5
Response with "postpone"	8

Assumptions of the share of private individual landlords who are high- and low-rate taxpayers

Portfolio size band	1	2-5	6-19	20+	Total
Share of landlords high-rate	8%	40%	75%	98%	30%
Share of landlords basic- rate	92%	60%	25%	2%	70%
Implied share of UK dwellings facing high-rate					56%
Implied share of UK dwellings facing basic-rate					44%

KEY ASSUMPTIONS (1)

- Landlords act as they have indicated
- Policy survey response analysed alongside respondents' base case answer. Any nonsensical responses were excluded by assuming the individual acts as they did in the base case
- Considering only private individual landlords
- Model does not account for new landlords entering the market given lack of data but this is consistent across scenarios and therefore differences from base case give robust indication of impact of the policies. The results will lead to conservative estimates because the implicit assumption is that the level of new entrants is the same in all scenarios, even when the policies are more positive or negative.
- There is a willing buyer/seller
- Average Stamp Duty paid based on official statistics on UK average Stamp Duty paid per additional property sale in 2020 (£5,862) and the implied effective tax rate (4.5%), giving the average UK gross amount facing additional Stamp Duty (£131,570). This was weighted by regional average house prices and the tax rate from before and after each policy applied.
- Average Capital Gains Tax paid based on official statistics on UK average Capital Gains Tax paid per property in 2020 (£11,082) and the implied effective tax rate (20%), giving the average gross amount facing additional Stamp Duty (£56,047). This was weighted by regional average change in house prices between 2011 and 2020 and the tax rate from before and after each policy applied, for high- and basic-rate taxpayers. Nine years is the median number of years landlords have owned their property according to the English Landlord Population Survey.

KEY ASSUMPTIONS (2)

- Average income and corporate tax paid based on a calculated average gross profit for landlords with a mortgage and without a mortgage. This was calculated using: the average regional house price in 2020, average regional rental yields, average regional maintenance costs, average buy-to-let mortgage interest rate over 2020 (2%), average loan-to-value ratio for landlords holding a buy-to-let mortgage according to the 2018 English Landlord Population Survey (55%). The current income (20% and 40%) and corporation tax (19%) rates were applied.
- Share of landlords with a buy-to-let mortgage was based on the average from the 2018 English Landlord Population Survey and weighted by regional likelihood of holding a buy-to-let mortgage.
- Assumed that the share of high-rate taxpayers for landlords holding: one property is zero per cent, 2-5 properties is twenty 20%, 6-19 properties is 50%, and 20+ properties is 100%.
- Assumed no change in house prices, inflation or interest rates over time, giving tax estimates in constant prices. For net present value estimates, we assumed a 3% discount rate over the ten years.