The party’s over: How private residential landlords are experiencing a changing policy and financial environment in Scotland

Farhad Farnood and Colin Jones
Heriot-Watt University
Introduction

- Within Europe, however, the nature and experience of the PRS in different countries is diverse
- Private landlords in the UK experienced a boom period between 1997 and 2007
- Drawn by the availability of mortgage finance and the combination of rental returns and capital growth.
- ‘Golden decade’ was brought to an end by GFC
- But this paper looks beyond this at the subsequent decade
Brief History Sketch

• At beginning of 20th century PRS was dominant tenure
• It experienced legislative control of both rent levels and security of tenure for most of century
• Owner occupation and social housing increased their share of the overall UK housing stock at the expense of PRS
• PRS was moribund
• *Housing Act 1988* reintroduced landlords’ right to set market rents and introduced six month tenancies and reduced security of tenure
Beginnings of a Revival

• 1988 Act was the potential basis for a revival
• BUT the housing market was in downturn that stretched through first half of 1990s
• PLUS finance for landlords was difficult
• In September 1996 a new mortgage product, ‘buy to let’, was launched tailored for people to invest in the PRS
• Lenders required properties to be managed by a registered letting agency and be let on six month tenancies
• Seeds were sown
Rise of Buy to Let

• By 2001 BTL lending became increasingly mainstream with high street banks and major building societies offering landlord mortgages.

• Private landlords soon began to flock to the market attracted by the combination of rental returns and capital appreciation.

• Across UK in 2000 just 4% of all mortgage advances were BTL but by 2006 this figure had grown to 29%.

• Nearly 7 times BTL loans made in 2006 as 2001 as housing market boomed.
Underpinnings of Boom

• BTL landlords benefited from a lucrative combination of a booming property market and high and rising rental returns
• Willingly assisted by mortgage lenders
• Highly geared investment, funding most of purchase price with mortgage
• Study in 2007 found BTL landlords had made an annual average compound return of 23.25% per year over previous five years
• Returns were remarkably consistent across all regions of the UK
Statistics of Returns

• Rental returns of 5%
• Asset values rising too
• Within period 1997 to 2007 there were five years – 1999 and 2001 to 2004 when total returns were almost or greater than 20%
• These assume 100% ownership
• Geared returns will be a lot higher taking into account the actual capital invested (perhaps only 5% of property values) and mortgage repayments
• Rises in asset values and remortgaging enabled some BTL investors to build their portfolios at a rapid rate
Global Financial Crisis 2008/09

- Extent to which BTL landlords were affected by GFC determined by point at which they entered the market.
- Early entry and the lower the leveraging the less the significant falls in house prices during 2008/9 would affect viability of a landlord’s investments.
- Those who entered at end of boom - highly leveraged may have become part of the dramatic rise in repossessions reported in 2009 and beyond.
- Dramatic profits accrued during boom but bust brought with negative equity, a collapse in returns and even repossessions.
- In 2008 10% of total repossessions were BTL with 4000 properties repossessed.
- Not until 2013 that repossession level began to return to pre-crisis levels.
No. of BTL Repossessions in the UK -2008 to 2015
Post GFC Market Characteristics

- Tightened lending criteria
- Lack of growth in property asset values
- Very low interest rates
- Strong tenant demand
- Unaffordability of home ownership
Recent Tax Changes

• Landlord buying after the 1st April 2016, pays an extra 3% charge
• Landlord in Edinburgh adding an average value property of £234,658 to portfolio has an additional cost of over £7,000
• Significant change to the treatment of mortgage interest relief on second homes including buy-to-lets
• Over 4 yrs the rate at which relief on mortgage interest payments can be claimed will reduce down to basic tax rate of 20%
• Higher rate (40%) tax payer landlords whose mortgage payments interest is 75% or more of rental income will no longer make a profit
• From 1 April 2016 Wear and Tear Allowance which enabled landlords to claim tax relief of 10% of rental income replaced with deductible receipted expenses for capital expenditure on replacements/ refurbishments
Regulatory Changes

• Since millennium landlords have been subject to a range of ‘consumer regulation’ on quality of the properties or way rent deposits are handled

• In Scotland we have new changes in rent regulation and increased security of tenure

• Not certain how landlords will respond
Conclusions

• During boom economics of being a private landlord became irresistible
• GFC brought these benevolent market conditions to an end
• However, GFC greatly reduced the affordability of home ownership as lending criteria tightened
• Result was PRS continued to grow as a proportion of all housing provision
• Private landlords in Scotland have been affected by policy and legislation from both the UK government in Westminster and the Scottish government
• Policies have reduced attractiveness of the PRS as an investment
• Squeeze on landlords fiscally and in regulatory terms
• But strong signs that PRS in Scotland is now a mature market based on the stability of tenure share, the more modest but consistent returns and the characteristics of regulation that match other mature private rental markets across Europe