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# The Private Rented Sector: its contribution and potential

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## EXECUTIVE SUMMARY

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## EXECUTIVE SUMMARY

### *Introduction*

The Review of the private rented sector (PRS) has taken place in the context of change for the sector. The long decline of the PRS has started to reverse, and the sector has begun to increase in absolute size and in terms of the proportion of households it accommodates.

Attention has become focussed on the capacity of the sector to meet a range of housing needs. At the same time there has been acknowledgment that the sector presents a number of policy challenges relating to such issues as property quality, management standards and security of tenure.

The Review has addressed the broad terms of reference set by Communities and Local Government by completing two principal tasks: detailed analysis of large-scale datasets, and an extended series of stakeholder meetings. Data analysis has underlined the highly complex nature of the PRS and the stakeholder meetings have helped to clarify issues around the efficacy of existing policy relating to private renting, and the need for further intervention.

At the heart of the Review is the desire to see private renting as a less marginal, poorly-regarded 'third' option that sits behind the preferred tenures of owner occupation and social renting. The Review concludes with a series of recommendations on policy 'directions of travel' that seek to maximise the full potential of the PRS as a flexible, well-functioning element of England's housing market.

### *Contribution*

The first section of the Review describes in detail the composition of the PRS and the contribution it makes to the spread of housing options in England. In terms of supply, a great deal of commentary has become attached to the impact on the PRS of buy-to-let mortgages, which are supposed to have led to a proliferation of new landlords. However, data indicate that 46 per cent of gross advances of buy-to-let mortgages in 2007 were remortgages: existing landlords were taking the

opportunity to refinance their portfolios on more favourable terms. However, the proportion of smaller landlords in the market *has* grown, as has the degree of investment intent amongst all landlords.

Many people will have some experience of renting privately during the course of their lives. Private renting offers a multitude of roles in housing biographies across the whole social spectrum, serving as a first port of call for new households, a 'bolt-hole' when housing circumstances change, a stopping-off point as people change jobs and move house, and – for many households – a long-term home. Twenty-one per cent of private renters had been living at their current address for five or more years. However, 'churn' in the PRS is high, reflecting the short-term nature of many of the uses of the PRS: 40 per cent of PRS households had been living at their current address for less than twelve months.

The PRS is complex, and perhaps best understood through mapping its constituent niche markets. These markets can be defined in terms of demand and supply characteristics, distinctive rental practices and – in some cases – specific types of central policy intervention that shape the way the sub-market operates. Policy for the PRS has to take into account the interaction of these sub-markets at a local level.

Distinct sub-markets include

- *young professionals*, whose presence in the PRS reflects a complex amalgam of choice and constraint;
- *students*, whose needs are increasingly being met by larger, branded, institutional landlords;
- *the housing benefit market*, where landlord and tenant behaviour is largely framed by housing benefit administration;
- *slum rentals* at the very bottom of the PRS, where landlords accommodate often vulnerable households in extremely poor quality property;
- *tied housing*, which is a diminishing sub-sector nationally but still has an important role in some rural locations;
- *high-income renters*, often in corporate lettings;
- *immigrants* whose most immediate option is private renting;
- *asylum seekers*, housed through contractual arrangements with government agencies;
- *temporary accommodation*, financed through specific subsidy from the Department for Work and Pensions; and
- *regulated tenancies*, which are a dwindling portion of the market.

The configuration of sub-markets will vary from area to area: even neighbouring boroughs may have very dissimilar private rental sectors.

The complexity of the sector has to be appreciated in any policy development, and underpins discussion of the obstacles and issues that attach to the PRS fulfilling its potential.

## ***Potential***

The Review addresses a number of areas where the sector is reportedly under-performing.

### *Delivering new and affordable property supply*

The need to accommodate an increasing number of households is a concern that is central to government housing policy, and attention has been focussed on the growth of the PRS. However, it remains to be asked how far the sector has provided a framework for bringing new housing to the rental market, or whether its expansion has been largely a consequence of absorbing existing property from other tenures. Data on this issue are not readily forthcoming. Despite the popular imagery, there are few data that firmly link buy-to-let mortgages with new-build property, although there is some evidence that this kind of mortgage is more likely to be used to purchase property built post-1964. It is possible that where the PRS is generating new property, the property tends to be in sub-markets where high-density build is appropriate. For example in the student sub-market, institutional investments are bringing new bedspaces through the building of large private-sector halls of residence.

The industry has argued for alteration in planning regulations that would actively require a certain amount of properties to be let on the rental market. This argument is generally proposed on the understanding that the sector should 'grow', although targets and objectives for this growth are rarely forthcoming.

With regard to affordability, it could be argued that the sector has been successful in meeting the housing needs of 'intermediate' households, whose income means that they are unable to afford owner occupation, but who are not in a priority group for social housing.

### *Securing higher levels of institutional investment*

The desire to secure higher levels of institutional investment for private renting has become a mantra for much of the industry, and has captured support from tenant representatives persuaded by the argument that institutional landlords will be,

perform, more professional landlords. It is argued that the 'cottage industry' PRS is volatile, tied as much of it is to the mortgage market and to the financial probity of individual landlords, and there is a need for a better taxation vehicle to lever in larger-scale investment to the PRS.

There is a long history to the attempts made to frame taxation regulations to effect large-scale institutional investment. The Review concludes that much of this debate reflects the attempt to construe residential letting as commercial letting, when in reality the two sectors are very different. The residential market has, at present, very few large landlords operating at a scale where major institutional investment is appropriate. Policies should therefore concentrate on helping good landlords of all sizes to expand their portfolios. It is important that this policy should include smaller landlords, since the larger landlords generally grow through portfolio acquisition. Suggestions include changes to stamp duty and to capital gains tax, to encourage portfolio development.

The Review also concludes that small-scale landlordism does not necessarily mean financial instability. Data indicate that many 'cottage industry' landlords are in a good financial situation: the majority have low loan-to value-ratios and many have unmortgaged properties. Small-scale landlordism is also characterised by a great deal of uncosted 'sweat equity', with landlords tending not to factor into their rents their time spent managing property. Larger institutional landlords, by contrast, have higher management costs and even where there are economies of scale, these costs will always constitute a substantial proportion of the gross to net reduction in their rental yield.

#### *'Professionalising' rental housing management*

One of the more frequent criticisms of the PRS relates to the quality of landlord management. However, poor management has to be judged in terms of intent: very many landlords operate professionally, but some landlords simply do not consider letting to be an activity that requires regulation, and other landlords – a very small proportion – wilfully act illegally. It is not possible to judge how many landlords fall into these three broad categories, or even to estimate the incidence of poor management practice. However, three quarters of private tenants were either very or fairly satisfied with their landlord.

Market forces do not adequately 'police' management quality in the PRS, since there is an excess of demand for rental property at the bottom of the sector. In general, the task of policing is spread amongst a number of agencies including different local authority officers, other statutory agencies including HM Revenue and Customs, the police and the industry itself. Local authority Environmental Health Officers carry the principal responsibility for policing the sector, but there is

dissatisfaction with the level of priority and therefore resources afforded this activity by local authorities.

A number of suggestions have been made to increase levels of professionalism amongst PRS landlords. It is thought that increasing the numbers of corporate landlords or increasing the use of managing agents would effect better management standards. However, tenant satisfaction levels are not necessarily higher amongst tenants of larger landlords. Managing agents are unregulated, and there is widespread dissatisfaction with their standards. Indeed, there have been calls for mandatory licensing of this part of the sector.

Accreditation carries the potential to improve better management practice amongst landlords who are already seeking to operate in a professional fashion. The expansion of accreditation schemes would lead to the possibility that market advantage would more readily attach to accreditation, as has been the case to some extent in the student rental sub-market.

Compulsory registration of landlords has already been introduced in Scotland, and there are calls to have similar regulation in England. However, the Scottish regulation requires landlords to meet 'hurdle' criteria, and the dissatisfaction with the process has become evident amongst landlords subject to delays in processing.

Overall, it is generally concluded that a patchwork of policing activity is suitable given the fractured nature of housing supply, but the current regulatory framework is not effective in allowing local authorities to target and sanction the small minority of wilfully bad landlords.

### *Improving property quality*

Property condition in the PRS has been improving over time, but is still worse than in either social housing or owner occupation. Fifty per cent of private rented property failed to meet the new decent homes standard. Households in receipt of at least one of the main means-tested benefits were more likely to live in properties failing to meet the decent home standard incorporating the housing health and safety rating system.

The economics of poor quality property is not well understood. Analysis of rental yields indicates that yields are higher on property in poorer condition, although these yields are reduced when voids and bad debt by tenants are taken into account. However, it is uncertain how landlords formulate their strategies on repairs and maintenance: EHCS data indicate that expenditure on property repair is not necessarily targeted on the properties most in need of repair, and landlords are not always knowledgeable about whether their properties meet statutory requirements.

There are further obstacles to improving property standards. The PRS contains more older stock than other tenures, and the average cost of repairs to bring units up to standard is higher than for owner occupation and social housing. There is scope for reviewing taxation frameworks around property improvement and consider the removal of any disincentives: for example, immediate tax relief is not available on improvement works and landlords have to wait until they sell property, to gain relief against Capital Gains Tax.

For many commentators, improvement to property standards will only follow if there is an extension to the regulatory regime. There are suggestions that all properties should be licensed. This measure would increase substantially the task of policing the sector by local authorities that are sometimes failing to meet existing mandatory requirements under the Housing Act 2004. The task of inspection and enforcement could be absorbed by accreditation schemes, which in some cases have been successful in improving property standards in some sectors of the market. There is scope for considering an enhanced role for managing agents, provided such agents are themselves strongly regulated. According to the 2006 EHCS, 41 per cent of dwellings where a landlord had used an agent were 'non-decent'. If it became mandatory for agents only to deal with properties meeting the decent homes standard, then much of the task of policing the wider market PRS would be absorbed.

A further suggestion is the introduction of competition amongst landlords for tenants at the bottom end of the sector. If tenants on housing benefit had access to a wider selection of properties then landlords owning the very worst quality accommodation would be pushed out of the market. Changes to the benefit regime, to introduce universal assistance with deposits and rent in advance, would mean that more landlords would be willing to accept tenants on housing benefit.

### *Providing sustainable tenancies*

Security of tenure is an issue that is central to any discussion of private renting. A number of commentators consider that the PRS provides only insecure, short-term housing: assured shorthold tenancies (ASTs) mean that tenancies turn over frequently, and tenants have little protection against landlords seeking eviction.

Analysis of the PRS for the Review has indicated that many of the uses of private renting are essentially short-term in nature. This fact distorts the data on 'churn' in the PRS. Some parts of the sector are more stable than others. For higher income groups, stays in private renting can be for very short periods. For the lowest-quartile income group, 36 per cent had stayed at their current address for five years or more.

A series of changes has been suggested to the existing tenancy framework. A strong lobby has arisen around the incidence of so-called 'retaliatory eviction', whereby a



landlord seeks to evict tenants because they complain about property repairs. However, it is difficult to pinpoint evidence that this practice is extensive. The suggested change – that the ability to serve a s21 notice should be prohibited to landlords who have received a complaint from a tenant – does not necessarily deal with what is essentially a symptom of very poor landlord management practice. A more effective approach might be to create a framework where it is more likely that this kind of landlord can be removed from the sector altogether.

It has also been argued that ASTs means that tenancies are short, and tenants obliged to move around 'every six months'. Data evidence indicates that just over half of AST tenancies last at least a year, and a fifth last three years or more. Nevertheless, tenants seeking a long-term tenancy may feel themselves to be insecure in the PRS.

Simplification of the legal arrangements has been suggested by the Law Commission, and there is some support for their recommendation that tenancy agreements should be remodelled, to become more transparent consumer contracts where tenancy terms are agreed at the outset between landlord and tenant. Although there is wide support for this principle, there is concern about the accompanying proposal that the six-month 'moratorium' on eviction offered by the current AST would be dropped.

The industry generally favours continuation of the current tenancy framework, although landlords themselves often favour tenants that seek longer tenancies. However, ASTs remain attractive to landlords because this kind of tenancy mitigates the perceived risk of letting to a tenant who then fails to pay the rent or damages the property. For many tenants, an assured shorthold tenancy suits their purposes, since only a short-term stay in a particular rented property is generally anticipated. The majority of tenancies are ended by the tenant themselves.

However, problems arise for the substantial proportion of households seeking a longer home in the tenure. Attention paid to the legalities of tenancy agreements has distracted attention from exploring the issue of *why* tenancies end against the wishes of the tenant, because it is assumed that – in the PRS – tenancies generally do. In actuality, tenancies fail for specific reasons, such as rent arrears, poor quality property making a tenancy unsustainable and issues relating to anti-social behaviour. It is perhaps more appropriate to focus policy intervention on these reasons for tenancy failure, rather than on a tenancy framework that appears – for the most part – adequate for purpose.

#### *Homelessness prevention and discharging homelessness duty*

Recent years have seen the convergence of two policy threads. First, since the late 1980s there have been a number of initiatives that aim to prevent homelessness

amongst 'non-statutorily' homeless households by easing their access to private sector tenancies. Deposit guarantee schemes are perhaps the most notable development. Second, and more recently, local authorities have been seeking properties in the PRS to help deal with their responsibilities to eligible, unintentionally homeless households under homelessness legislation.

It is often argued that it is feasible to expect the PRS to expand to meet additional demand for property from low income and/or homeless households. Indeed, the PRS has a distinctive housing benefit sub-market. However, there are questions that relate to capacity. Landlords can be very reluctant to deal with households in receipt of housing benefit, and as a consequence there is a substantial amount of unmet need for accommodation in the housing benefit sub-market of the PRS. The level of need is evidenced by the range of incentives that have been developed to encourage existing housing benefit landlords to expand their portfolios and to induce wider-market operators to enter the sector. Incentives can include expensive leasing arrangements, which tie statutory authorities into arrangements to guarantee rental payments to landlords over three or five years, irrespective of whether their properties are tenanted.

Furthermore, increased use of the PRS to provide long-term accommodation for eligible, unintentionally homeless households will probably impact on the supply of property to households for which there is no such responsibility. This group – including for example, single people or young couples without children – have always relied on the PRS as the principal source of accommodation. Statutory agency interest in the PRS introduces a further level of competition for property at the bottom of the sector, particularly if those agencies introduce incentives for landlords to let to particular nominated households.

Leaving to one side questions about the ability of the sector to meet demand for property at the lower end of the PRS, there are questions about tenants' ability to pay the higher rents that are charged in the sector. Overall in England, spending per recipient on housing benefit in the PRS was £98.51 per week, compared with £65.38 per week where the tenant was in a local authority property. Furthermore, there are more acute work disincentives operating where a tenant is in receipt of housing benefit in the PRS, as a higher income is required to shift a household off benefit dependency.

In addition, it could be argued that a tenancy in the PRS would not be regarded by tenants as a housing 'offer' equivalent to a social housing tenancy. Tenant satisfaction with social housing can be low: for example, the presence of drug dealers and users, litter and rubbish in the street and troublesome teenagers/children were more likely to be regarded as a 'serious' problem by social housing tenants. However, the perceived problems with property quality, security of

tenure and affordability all play a part in persuading tenants that the PRS provides – at best – an insecure home.

### *Managing 'problem' private renting*

A number of tools are available to local authorities to manage the incidence of problems that might emerge where there are particular concentrations of rental demand in a given area, and the Review considered responses to student housing, to 'slum' landlordism and to migrant worker overcrowding.

The concentration of student rentals in the vicinity of higher education institutions has attracted a great deal of policy attention. It is argued that student renting 'destabilises' communities, 'prices out' owner occupiers and first-time buyers in particular, and subjects longer-term residents to noise and rubbish nuisance. However, census data demonstrate that intensive student habitation is not common: there are more than 8,000 wards in England, and of these just 59 had student densities where a student household reference person comprised ten per cent or more of all household reference persons in the ward.

Despite the low incidence of this problem, lobbyists seek a change to the Use Classes Order, which would allow local authorities to effect tighter control of HMO numbers and so limit student housing numbers in a given area. However, it could be argued that many of the 'housing' problems being described are in fact policing issues. There is a general willingness to use criminal sanction to contain anti-social behaviour when it is connected with deprivation and social exclusion on social housing estates. However, there is an understanding that student behaviour – however threatening, damaging or disruptive – should stand outside the law. In addition, it could be argued that much of the 'environmental' anti-social behaviour is adequately covered by existing environmental health regulations, providing local authorities choose to prioritise this problem.

Leaving these issues to one side, there has to be a 'common sense' acknowledgement that demand for property from students and higher education staff will be a consequence of the presence of a higher education institution in a particular locality. If student demand was not spatially concentrated in houses in multiple occupation, then demand for property would be even more intensive, and students – unable to live within walking distance of their place of study – would seek alternative transport provision. It is perhaps also worth remembering that higher education institutions are deemed to be so beneficial to the local economy that the government is seeking to establish twenty new higher education centres as a means of effecting area regeneration and job creation.

'Slum' landlordism is evident in many localities, where the concentration of very low quality rental creates an area of high-turnover tenancies. Local authorities in some

areas have used selective licensing as a way of dealing with these areas. More could be done to share experiences of the use of selective licensing, and perhaps some change could be made to the regulations to 'uncouple' the provision that this measure is only applicable in areas of low demand.

For many local authorities, migrant worker overcrowding has become a problematic feature of the local PRS. This is particularly the case when increased and intensive demand for rental property has become evident over a very short period of time. Overcrowding can lead to public health issues. Problems in framing appropriate policy solutions are compounded by the fact that the housing and labour market linkages can be closely intertwined. For example, migrant workers might be living in tied accommodation; their presence might be very necessary to a seasonal economy; and the workers themselves might be choosing to over-occupy so as to minimise their housing costs. Best practice guidance appears to be lacking for local authorities dealing with the problem.

Underlying much of this discussion is debate on the way that local authorities approach the task of 'managing' the PRS. There was general agreement that appropriate tools were available, providing that local authorities were in a position to resource PRS-related activity. The Audit Commission inspection regime indicated that local authorities did not score with regard to their PRS responsibilities. Aims for strategic management of the PRS tend to be framed in terms of containing demand for private rented property, and assessing how far the local market had reached a defined 'tipping point' in the number of shared properties in an area.

A better approach might be to assess reasons why a particular area might have a highly transient rented population. In some locations, the transience might simply reflect the roles that the PRS in a given location is playing in supporting the local labour market. Greater attention needs to be paid where the transience reflects the inability of a low-income households to settle in the PRS.

### *Policy directions of travel*

The report concludes by outlining six policy 'directions of travel'. These policy areas are largely thematic, and relate to underlying trends in the 'issue-based' chapters of the Review report.

First, the report underlines the need for development of **a sound evidence base**. A great deal of policy is devised on the basis of poor-quality evidence produced by industry or tenant lobby groups. A firm understanding of the PRS and the way it operates tends to be lacking amongst policy makers at a national level and officers implementing policy at a local level. Transference of knowledge on the PRS is poor across government departments, which is reflected in a lack of co-ordination at a local level. As a priority, the government should review information collected

through the national data sets to ensure that more pertinent questions are asked of landlords and tenants.

More policy is needed to encourage **a better understanding of managing rented housing**, amongst landlords and managing/letting agents and amongst local authorities devising strategies for addressing issues in the PRS. Managing agents should be subject to mandatory regulation to ensure better quality management standards, and registered social landlords should be encouraged to enter the marketplace and sell their rental management skills to private landlords and property investors.

The government should devise initiatives to **'grow' the business of letting**, encouraging smaller, good landlords to expand their portfolios and move into the business of letting full-time, and helping larger corporate landlords to increase their lettings and so attract higher levels of institutional investment. Changes to the tax regime should be framed to encourage landlords to view their letting activity as business rather than investment activity, and buy-to-let mortgages should be available subject to business planning and the inclusion of strategies to protect tenants in the event of a default on mortgage payments by the landlord.

Low-income households should be able to make a real choice between a social or private let. **Equalising the rental choice** should be the aim of a series of policy objectives, to ensure that a PRS tenancy can be viewed as being equally desirable by households who would generally look to the social sector for long-term housing. Tenancy sustainability should be a core PRS policy objective. Social lettings agencies could be established to deal with all the private renting procurement required by statutory agencies in a given area. These agencies should charge a standard management fee, and move the housing benefit market away from a culture of 'incentive inflation'.

The existing regulatory framework does not offer sufficient sanction where landlords openly contravene regulations. **Light-touch licensing and effective redress** can encourage local authorities to target the very worst landlords, by ensuring that effective sanctions are in place. A permit or licence would be required by all landlords, but would be available without any hurdle criteria on payment of a small fee. Nationally administered, the licence would be revoked if the landlord did not meet statutory requirements on housing management and quality. The licence fee income would finance the establishment of an augmented system of housing redress.

There is insufficient evidence that existing **tenancy frameworks** are problematic. Many of the foregoing measures will lead to private letting being regarded as a less risky activity by both landlords and tenants.

## *Conclusion*

The PRS is a key component of the housing market in England. The flexibility of the PRS needs to be protected, and policy interventions should flow with the market rather than seek to change its essential characteristics.

High-level co-ordination of policy between government departments would contribute to the task of framing a 'cross-departmental' culture for local-level intervention in the PRS. A Ministerial statement of intent would help to underline the importance of the sector to the operation of housing and labour markets, and encourage local authorities to seek a 'private rented' dimension to National Indicators.

Use of the PRS to accommodate more households on low incomes must follow from rather than drive initiatives to improve private renting: when the sector is seen as an affordable, secure environment in which to make a long-term home, there will be little need to devise policies to encourage households into private renting.

*The Review of the private rented sector benefited substantially from being an independent exercise. Communities and Local Government provided broad terms of reference, but the structure and final conclusions of the report remain the authors', as do any errors or omissions.*



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