

Cambridge Centre
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Landlord portfolio management - past and future

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1. Introduction

This research, funded by Shelter, explores how landlords manage their portfolios and make decisions over buying and selling stock, how landlords manage their businesses, how this might affect tenants and how this might change in the future.

The private sector provides homes for millions of people, including an increasing number of families. This means that an increasingly large number of people are exposed to the decisions that landlords make about their portfolios. Landlords are a diverse group of people and institutions, and little is known about what motivates and informs their business decisions and what might cause them to change their practices.

The research involved in depth interviews with a range of private landlords in England exploring how they made decisions over buying and selling stock, and how they may respond to recent tax changes and developments in the wider economy.

Methods

The research comprised.

1. A short desktop review of relevant policy and publications
2. Interviews with five stakeholders, comprising:
 - The National Landlords Association
 - The Residential Landlords Association
 - Nationwide (Mortgageworks)
 - The Southern Private Landlords Association
 - A mortgage broker
3. Interviews with a stratified sample of landlords. In total 30 landlords were interviewed.

Sampling private landlords is notoriously difficult as there is no ready sampling frame. We therefore used a stratified approach, aiming to include a spread of landlords which were broadly reflective of the profile of the private rented sector. This drew on the data shown below, taken from the 2011 census and DCLG's 2010 private landlords survey:

	Criteria	National profile	Target number	Achieved
Location	London	22%	6	8
	North and Midlands	42%	13	14
	South	36%	11	8
Type	Individuals	71%	21	22
	Companies/other	29%	4	6

	Mixed portfolio	n/a	5	
Size	1	40%	12	9
	2-4	21%	7	6
	5-24	17%	5	6
	25-100	10%	3	4
	More than 100	11%	3	4
Years since started letting	3 years or less	13%	4	2
	4-10 years	35%	10	10
	11-20 years	22%	7	9
	More than 20	29%	9	9

Source: Location: 2011 census; Type, size and years letting: DCLG 2010 private landlords' survey. Note, that landlords have been categorised by the area where they held most of their properties. Four of the landlords operating through a company structure, also owned properties as an individual.

Landlords were contacted through a range of methods including web-based searchers for homes to rent and respondents of a previous project who had agreed to re-contact. Institutional and larger landlords were drawn from existing knowledge of the sector including large individual and corporate landlords as well as landlords linked to insurers, pension providers and the capital markets. Senior named representatives of these institutions were contacted by email and by telephone to arrange mutually convenient interview times. It should be noted that, despite the overall profile of landlords being reasonably close to the targets set (see Table 1), researchers noted a large proportion of landlords declining to take part in an interview, including a disproportionate number of those for whom English appeared to be their second language. This may have affected the representativeness of the sample achieved.

Landlords were asked about their current business practice, plans for the future, their experience of buying and selling properties, the impact of tax reforms thus far and how they might respond to a variety of economic changes such as a hike in interest rates or changes to market rents.

2. Context

The private rented sector in England has grown rapidly over the last 20 years, faster than the increase in the total housing stock. This has been accompanied by a compositional change in who rents, with more older people renting, and more families with dependent children than ten years ago.

The reasons for this growth are complex – and have at least as much to do with changes in the other tenures as changes in the private rented sector itself. For example, the declining supply of social rented housing and dwindling affordability of home ownership have both led to an increase in the number of households only able to access a private rented home.

However, future changes in government policy or economic conditions could directly affect the attractiveness to landlords of rental properties as an investment and may therefore influence the size of the future private rented stock.

Changes to taxation

There has been growing concern among policy makers that the growth in the private rented sector may have come at the expense of some would-be first time buyers, who find themselves unable to compete with buy-to-let landlords and stuck, involuntarily, in rented housing when they would prefer to own. To help redress the balance between landlords and owner-occupiers, the government has made a range of recent reforms to taxation of private landlords, including:

1. Removing the fixed 10% wear and tear allowance on furnished lettings
2. Increasing stamp duty by 3% for purchase of buy to let and second homes
3. Allowing mortgage interest to be offset only against basic rate tax

The removal of the wear and tear allowance only affects landlords of furnished lettings. Previously, these landlords could choose to offset a fixed allowance of 10 percent of their rental income for maintaining furnishings or the actual expenditure, if that was higher. From April 2016, the 10 percent allowance was abolished and landlords can instead only offset actual expenditure against tax.

The stamp duty change levies an additional three percent stamp duty on all purchases of buy to let properties and second homes. This includes low value properties which were previously exempt from stamp duty and which now incur a three percent charge.

It is the third of these reforms, the changes to mortgage interest tax relief, which are the most complicated, and where the impact varies most between different types of landlord, depending on their personal situation and level of mortgage debt. Landlords have previously been taxed only on the profits from their rental business after deducting mortgage interest payments as a tax deductible expense. However, from 2017 to 2020, new rules are being phased in which limit the amount of tax relief on mortgage interest payments to 20 percent, rather than 40 percent or 45 percent, as would normally be claimed by landlords with higher gross incomes. This has two main effects: it increases the tax bill for landlords whose gross income from letting properties is in excess of the higher rate tax allowance (currently £45,000) and it also makes it much harder for landlords to assess and calculate the tax they will pay on their rental income. This is because currently landlords simply need to work out their profits, add on other income, then apply tax at the usual rates (in bands of 20%, 40% and/or 45%). With the new rules they need, instead, to work out their gross income – including gross rental income – then work out the extent to which this is over the higher rate tax threshold, then work out how much mortgage interest is currently being offset against

higher rate tax, then work out the difference between this and the new allowance for mortgage interest. To help clarify the amount of the tax that landlords will be liable to pay under the new regime, organisations such as *The Telegraph* have produced calculators which can work out the impact on different types of landlord¹.

Previous research published by the CML last year suggests that the majority of landlords will be unaffected by the reforms, for instance because their gross income (including rent) is still below the higher rate tax threshold, because they do not have any mortgage debt or because they own properties through a company structure rather than as This research found that around half of landlords had no mortgage debt at all (Scanlon & Whitehead, 2016).

However, others will be affected - even if they are not currently higher rate tax payers - if their gross income from rent (along with any other source of income) is over the higher rate tax threshold. In many cases, the impact may be small, but for landlords with a high degree of borrowing and small profit margins, it is possible for the tax due to be higher than their rental profits in financial terms. The CML research explored the profile of landlords in more detail, giving some insight into which ones would be more vulnerable to the tax changes.

Landlord trade bodies and some individual landlords have been opposed to these reforms, arguing that they may make businesses unprofitable, or that they will need to pass on the increased costs to tenants².

What is not so clear is what will actually happen in practice – whilst research by the NLA predicted large scale sell offs, emerging evidence appears to suggest that landlords are still more likely to say they intend to grow their portfolios rather than shrink them (Sateriale & Offord, 2017; Scanlon & Whitehead, 2016; YouGov, 2017). What landlords say they will do – especially in reaction to recently-announced unwelcome changes – may not necessarily reflect what happens in practice.

The government has attempted to phase in the reforms to income tax, presumably with the intention of avoiding any shock responses. However, the extent to which landlord behaviour may be influenced by the behaviour of other landlords, and anticipations of future changes to house prices or rents, are also not well understood.

Welfare changes

Welfare payments to cover rent have undergone significant change in recent years and are still undergoing change. Although they do not affect all private renting households or landlords, with almost 28% of private renting households in receipt of some form of housing welfare payment, welfare policy affects a significant proportion of the market³.

The introduction of Universal Credit has made some significant changes that can affect claimants' ability to pay their rent. For example, under Universal Credit claimants must

¹ www.telegraph.co.uk/property/buy/buy-to-let-calculator-how-will-new-tax-reduce-your-profit

² See www.propertywire.com/news/uk/tax-change-result-uk-landlords-putting-rents-20-30/

³ English Housing Survey 2014/15, table FA3242

typically wait for at least five to six weeks before they receive their first payment. Although government policy has preferred payment of housing benefit to tenants rather than landlords since 2008, it is more difficult for landlords to have the payment directly made to them under Universal Credit

Furthermore, the amount that benefit recipients are able to claim for their rent is also shrinking in real terms. Local Housing Allowance rates – the maximum claimable amount of housing benefit or the housing cost element of Universal Credit – have increased less than rents since 2011 and are now frozen until 2020. Other cuts affecting specific groups include the benefit cap, which has also reduced payments to many families, particularly in high rent areas and the restrictions on housing benefit for under 21s. As a consequence, there are significant and growing gaps between the amount that tenants are able to claim in some housing markets and rent levels, meaning that landlords potentially face a growing risk of arrears⁴.

The economy

Alongside these policy changes, there is also economic uncertainty – the impact of Brexit is yet to be known, but inflation is rising, meaning that interest rates may at some point do so too, particularly if the pound falls further against other currencies. This could herald the end of the historic low interest rates and a rise in the costs of borrowing, affecting buy to let landlords and the housing market overall.

Mortgage lenders have also responded to the changes in income tax relief, resulting in a steep fall in buy-to-let mortgage products⁵. The CML therefore predicts a slight fall in buy-to-let lending over the next two years (Clarke, 2017).

Evidence of any actual impact on landlords deciding to sell properties is, however, hard to find - there is no up to date data on the size of the PRS capable of measuring recent changes in its size, and no reliable source of information on sales of formerly-privately rented homes. While there is no evidence of a mass exodus of landlords from the market, it is harder to know whether landlords may be making more gradual changes to their business practice, selling off stock as it becomes vacant or unprofitable, or no longer buying new properties.

The impact on tenants

If the PRS does become less attractive to landlords to the extent that they sell homes, this could have severe adverse consequences for tenants. They would lose their home at a time when the supply of alternative rented housing may be reduced, potentially triggering homelessness. Whilst some first-time-buyers would benefit from a reduction in the size of the PRS (and comparable increase in sales to owner-occupiers), these are not necessarily

⁴ Analysis: Local Housing Allowance freeze, Shelter 2017

⁵ See www.telegraph.co.uk/investing/buy-to-let-mortgage-deals-dry-lenders-pull-back/

the same households who would lose their rented homes. Some first-time buyers may be currently living with other households (such as their parents), whereas the lowest income renters, still unable to afford to buy, would be most at risk of homelessness in a situation where landlords exited the PRS. The ways in which landlords manage sales of properties they no longer wish to own matter here, especially whether they can only sell with vacant possession or whether there are circumstances in which properties can change hands with sitting tenants retaining their homes.

The aim of this research is therefore to understand these issues better and to establish what factors could lead to a 'landlord flight' scenario. The research will also investigate what more could be done to reduce the risks for tenants of landlords exiting the sector.

3. Landlord motivations and decision making

Different landlords, different motivations

The research included a wide range of landlords, from those owning a single property, or two to four properties (hereafter referred to as small landlords), to medium sized landlords (owning five to 100 properties) to large ones, with 100 or more properties. Some of the medium sized landlords operated all or part of their business through a company structure, but were the sole director and owner. It was very clear that the largest institutional landlords were fundamentally different in their approach from the small to medium sized ones. Understanding how different types of landlord make decisions is therefore critical to understanding how policy changes and economic shocks could potentially affect the private rented sector in England.

Becoming a landlord and buying properties

For the larger institutional investors, investment in residential property was a very deliberate decision, and three of the four large company landlords had entered the sector within the last five years.

Of the smaller landlords, around half had made a definite decision to invest in properties:

It was just investment – if you could buy a house for £100,000 and sell it for £200,000, that would be a good investment for us as a family.

(8 properties, Midlands)

I just wanted a regular income, you know, something like a pension pot potentially, and I thought property was a good investment at the time.

(1 property, Midlands)

I bought it entirely as an investment.... Essentially I was in a position financially to invest some money, basically through the estate of my family.

(1 property, London)

Others described themselves as accidental landlords and described a range of personal circumstances that had led to them starting to rent out property:

We moved from Stroud to Shrewsbury. We decided to let the Stroud house as we weren't sure if we'd want to move back to Stroud. We knew someone who wanted to rent it so it was easy to do that. When they left, we tried to sell it, but found it hard to sell, then the sale fell through so we got a buy to let mortgage on it instead.

(1 property, South West)

It's a flat that I had, and I moved in with my partner many years ago, and I've just rented it thereafter for a number of years.

(9 properties, Midlands)

I moved to Hertfordshire further into my career, but I kept the flat because I wasn't sure if I wanted to move out of London, so I rented it out, and then house prices just kept going up. And then when I had my child, I wanted to move back to Newcastle, so I rented out the one in Hertfordshire, again just because I didn't know if I wanted to go back...So I didn't really do it for a commercial purpose originally.

(3 properties, different locations)

Some of these accidental landlords were then encouraged by this experience to develop a business in letting properties,

I couldn't sell my own house so I ended up just letting it out in the short term. And that was the best thing that I ever did, and that's what started this off.

(5 properties, North East)

I got left one by my mum, and I had my own one, that was about it. And then I just started gradually buying houses.

(49 properties, North East)

The large institutional investors, in contrast, made carefully planned decisions to build and rent or buy to rent in a particular area based on estimated demand and long-term (up to 40 year) calculations of the rental return. Capital growth was less central to this decision, as the intention was to retain the properties long-term for their rental yield.

The business was started in 2012 and was launched with no properties. We currently have 320 under management. Another 370 come on stream this year and there are another 300 committed over and above that. Our financial model is based on rental income – our exit is based on rental yield; not based on capital growth.

(320 properties, mostly London and the South East)

We are in the midst of developing and building. We take pension fund money and invest in the rental sector. We own everything we build and have 1200 units under construction and first lettings in May. We will aim to add around 1,000 units per year – all new build.

(1200 properties, mostly London and the South West)

The majority – 90-97% are purpose built flats. We chose flats because of the availability of the stock and because of housing management considerations. Also, the return is higher... We decided to expand in 2012 and we aim to reach 20-25 thousand units over the next ten years, or a little longer.

(1,500 properties, Greater London)

This bears out the results of research carried out amongst institutional landlords (Clarke, et al., 2015).

Some of the medium sized landlords had grown their portfolios, though in a more opportunistic fashion, buying when they had the money, or when good opportunities arose:

[My wife] selected properties that were decent, that were good value. We wanted to have a spread across the board.

(8 properties, North East)

I now own 31 properties. I'm a chartered building surveyor, so I know the business – I've been buying since 1990, although I haven't bought anything since 2011.

(31 properties, London)

We (three partners) built up a business over the last thirty years which now owns 65 properties.

(65 properties, London)

In contrast, some of the smaller landlords had bought no further properties since they first became landlords and had no interest in buying any more.

Choice of location

This was an area in which the larger institutional landlords made decisions very differently from the smaller ones.

Of the 26 small and medium sized landlords (owning up to 100 properties), all but one had bought properties in the area in which they already lived, or were familiar with and visited regularly.

Originally my wife was down in London a couple of times a week, so the original purpose was for her to live there part time with my niece. But in the end that didn't happen and we're just letting it out now.

If you were to take an area from the River Humber up as far as the River Wear and then across to the Pennines – it's 100 miles North-South, 50 miles East-West, that's my farm!.... I live in York – in the middle of my area.

Just one medium sized landlord had bought in an area he considered to be a good investment (East London).

In contrast, the large institutional investors had made very careful decisions around the areas in which to invest, based on their analysis of the achievable rent and likely future demand for their housing.

Selling properties

The majority of landlords interviewed had never sold a rental property. In total, 11 of the 30 landlords had sold a property – eight of these had sold one each, for reasons relating to a change of personal circumstances: three had moved to a new area of the country and did not want to manage a property so far away; three needed the cash (to buy out a co-owner, to help children buy houses, and to buy themselves in a new area); one felt that the property (a quirky old cottage) didn't fit his overall stock profile and one said he was unable to let it which he believed to be because of racism against white landlords in the local area.

Five of the eight sales resulted in the landlords purchasing a replacement rental property in a different location or of a different type.

In addition to these eight individual sales, one of the larger medium sized landlords reported that they had sold ten properties recently in order to reduce their borrowing in anticipation of the forthcoming changes to income tax allowances. Two of the large institutional landlords had each sold two properties in recent years – in both cases for housing management reasons in order to purchase properties with a better yield, and in one case also in order to demonstrate the liquidity of the asset base.

The sample of current landlords, of course, excludes people who have been a landlord previously but have now sold their stock. Several of the stakeholder organisations gave an overview of reasons why landlords typically sold up, reporting that it was often older landlords who were no longer wanting to be managing properties. A few of the landlords also discussed ageing and retirement as possible reasons to sell up, though an alternative strategy was reducing borrowing (by not buying anything more) and then using the rental income to employ a management agency to manage the properties when they were too old to do so themselves.

Other landlords who had not yet sold any properties speculated on what might prompt them to do so. Needing the cash for personal reasons was one factor mentioned, as was getting older and being unable to manage the properties:

We'll be retiring in 3-4 years, and are trying to decide whether to sell it now, or else put some effort in when we retire to do it up, and then either do it up or sell. We'd have the time for it then – working full time right now and it's not local.

(2 properties, South West)

The decision to sell would be when I get fed up doing it. I'll be 80 next year. I don't want to be climbing up roofs and unblocking gutters forever.

(1 property, South West)

Many of the smaller landlords indicated that they could be flexible about when to sell, and might well do so if they were struggling to let a property, but could otherwise see little reason.

[Other] landlords have sold up because the students are not available any more in Plymouth – the students are all going to these big blocks [of purpose built student housing]. ... The main issue that would prompt me to sell would be if it was empty, and I couldn't let it.

(1 property, South West)

Three of the stakeholders interviewed stated that growing regulation is a reason for landlords leaving the sector -- though none of the landlords cited this as an issue. This included the nine landlords who as at least part of their portfolio managed houses in multiple occupation (HMOs), which are more closely regulated than other rental properties. However, some other landlords did indicate that they were unwilling to let properties as HMOs because they were a “specialist area”.

The impact of the tax changes on decisions to sell is discussed later in this report.

Reasons for not selling

The main factors that deterred landlords from selling properties were the rental income, the expected future growth in value and capital gains tax.

Rental income was important to large and small landlords alike:

It's like an income for me. I consider it like that, when I hopefully retire in 10 years, £600 a month towards my pension.

(9 properties, Midlands)

The business model is that we do not sell. Our business plan is to hold for 40 years or more, to fund pensions.

(1,200 properties, London and the South East, set up to invest pension funds)

The institutional landlords were clear that their business model was to hold properties for the long term and not to sell except in very exceptional circumstances.

Meanwhile, the small landlords were particularly motivated by potential capital gain, despite the fact that most did not intend to cash in on this value in the foreseeable future.

Overall, there was a view that the tax system discouraged buying and selling properties in order to rationalise stock, as stamp duty would be incurred on each sale and capital gains tax payable on profits made. Smaller landlords also cited the general difficulties and hassle of selling as a reason to avoid it:

Our experience of selling houses is that it's a pain, and stressful.

(1 property, South West)

Selling with tenants

Landlords were asked more generally on their views on selling with a sitting tenant. Tenants with assured shorthold tenancies (ASTs) can be evicted at the end of a fixed term tenancy, or with two months' notice if their tenancy has been allowed to become a period tenancy. Landlords can therefore choose whether to evict a tenant and sell a property vacant, or try to sell it to another landlord with the tenant remaining in their home.

A couple of landlords were confused by the term “sitting tenant” and said that they would use this term only to apply to tenants with pre-1988 secure tenancies, who cannot be evicted in the same ways as those with an AST.

Of the eight individual sales, three properties were already vacant at the time the landlord decided to sell (and in one of these cases, this was the main reason prompting the sale) and three properties had tenants who had come to the end of a fixed term tenancy which was not renewed (because the landlord wanted to sell) and one served notice in order to sell. None of these landlords had considered the option of renewing the tenancy and seeking to sell to another landlord. One further property was sold to the existing tenant, who happened to be looking to buy at the time the landlord needed to sell.

One of the two institutional landlords had sold two tenanted properties to another landlord, though stated that they would likely look to sell with vacant possession in the future in order to secure a higher price; the other institutional landlord that had sold two properties had chosen ones which were already vacant to sell. The landlord who sold ten properties said that they had recently evicted long-term tenants from these properties in order to sell with vacant possession.

Landlords were asked their views on selling properties with tenants. A few landlords had experiences of buying tenanted properties, which had gone well, and therefore encouraged them to consider this in the future. Some stated that they would consider this if the tenant had a good payment history, and the property would suit another investor.

It depends on the history of the tenant, all of the sort of information you'd disclose in the sale - whether there's any arrears, whether they're housing benefit tenants, whether they're white collar tenants. A lot of things will affect the sale.

(50 properties, West Midlands)

Two of the four large institutional landlords said that if they sold, it would likely be to another landlord (and one of the other two had never considered selling):

The only reason we would sell is if we could get stronger rental growth somewhere else. In that case, then we would probably sell tenanted blocks to another landlord.

(1200 properties, London)

Houses in Multiple Occupation (HMOs), for instance, were identified as a type of property likely to sell to another landlord and therefore something that could be sold whilst tenanted. The continuation of rental income during the marketing period was also attractive. Some of the stakeholders felt that the growth of the rental market meant that selling to another landlord was now easier, and no longer reduced the price:

In the past, it would always be sold vacant – nowadays if you have a good tenant it often makes no difference to the money you get.

(Stakeholder)

One of the larger institutional landlords concurred:

When we set up the business, an empty block of flats was worth significantly more than tenanted. The discount now is five percent or less. We believe once the building starts trading, it will be worth more tenanted.

(320 properties, London and selected cities)

Other stakeholders, however, felt that vacant possession attracted the highest price:

They'd normally sell empty because it is worth more.

(Stakeholder)

They'd sell with vacant possession because of the price premium. Also, it takes on average seven months to get a property back via the courts if you buy with bad tenants.

(Stakeholder)

Most landlords also concurred that trying to market a property with a tenant still there would reduce their potential market, as owner-occupiers would not want to risk of the tenant failing to leave when asked. Some felt that it would be unfair on future landlords to expect them to take on a tenant of someone else's choosing, and in one case that it would be unreasonable to expect a tenant to deal with property viewings.

We would tend to sell with vacant possession because of higher values.

(1500 properties, London)

There's lots of red tape and solicitors recommend the fact that you buy it empty. It's a lot easier with regards to like tenancy agreements and background checks and things like that. Also, it's not fair on the tenant as, well, if I lived in a property and somebody wanted to come and have a look because they were putting it up for sale it's not very nice is it.

(8 properties, North East)

I think it would drastically reduce the audience I was dealing with. It doesn't give a good impression. I think I would much rather sell an empty house, which is what I'm doing with this one, I'm selling it as brand new.

(5 properties, North East)

Many of the smaller landlords had not really considered the issue:

We didn't consider selling it with sitting tenants. We just assumed someone would want to buy it to live in.

(1 property, West Midlands)

I haven't even thought about it to be honest. I'd speak to an estate agent and ask advice.

(2 properties, South West)

Some of the stakeholders felt that landlords might consider this option if there were financial incentives in the form of relief from stamp duty (for buyers) or capital gains tax (for sellers).

Stakeholders and landlords were asked when a landlord would serve notice if they wanted to sell with vacant possession – i.e. before marketing the property, or only when a sale was agreed.

The stakeholders interviewed said that this would depend on market conditions: in a fast-moving market landlords would generally serve notice before marketing the property, in the expectation that it would sell quickly, whereas in a less buoyant market, they might market

the property first so as not to lose rental income whilst waiting for it to sell. Landlords interviewed were mostly unable to comment on this distinction as they did not operate in sufficient range of markets to make this distinction themselves. Rather, those who did not need to sell urgently said that they would be unlikely to consider selling unless their current tenant left, which would mean the property was already vacant.

All of the large and medium landlords said that they would be keen to rehouse tenants into another of their properties if they needed to sell the one they were in, as long as they were good tenants. However, there were no instances reported where this had actually occurred from the limited number of evictions in order to sell reported, some of which were by small landlords with no suitable alternative provision.

Responses to changes in taxation

The wear and tear allowance

The changes to the wear and tear allowance only affect landlords who let properties furnished. Of the 30 landlords interviewed, 17 let at least some of their properties furnished so would potentially be affected by this reform.

Landlords' understanding was mixed. Six (mostly small) landlords appeared unaware of the abolition of the wear and tear allowance. One said that they had never been aware of the allowance in the first place, and another was aware of it but had never claimed it (considering it more reasonable to claim actual expenditure, even though this was typically lower). Four were aware of the change, but unaware of how it would affect them, stating that their accountant would deal with that, or that it would not affect them until their next tax bill arrived. One landlord said that the reform would not affect him because he did not declare his rental income to the Inland Revenue anyway, and a second was (probably incorrectly) declaring his rental income under the Rent a Room allowance, so was unaffected. Just one landlord reported that it would make no difference to them as they typically spent at least ten percent of their rental income on furnishings anyway, as they dealt mainly with HMOs where tenants tended to exert heavy wear on furnishings.

Two landlords (one small and one medium sized) reported that they were intending to switch to unfurnished lettings as a result of the abolition of the wear and tear allowance, as they were less hassle and the financial incentive to provide furnished lettings was no longer there:

We were letting furnished, and making full use of the very generous wear and tear allowance. The abolition of this has torn a hole in our business plan, and we are shifting to unfurnished.

(65 properties, London)

Two medium sized landlords both with substantial borrowing (and hence affected by other tax changes too) said that they were raising rents to cover the extra tax now due.

Overall, there was a clear view from the stakeholders that the abolition of the wear and tear allowance, whilst hitting profits for most, was a reasonable reform and manageable in financial terms:

There was not a strong enough argument to keep it.

(Stakeholder)

It's not a major measure. We opposed it but not vigorously. It's difficult to justify.

(Stakeholder)

Government have considered this over-generous for some years and I agree. ... Now furnished landlords can claim in a normal way for renewing things. It is right to claim what you spend.

(Stakeholder)

Stamp duty

The three percent increase to stamp duty on all buy to let and second home purchases was the best understood of the three tax changes explored in this research. This was the best understood of the tax changes and all but one of the interviewees were aware of the change and how it would affect them if they bought more properties.

Around half the landlords did not feel that the stamp duty changes would have any impact on them because they were not intending to buy any more properties. Of those who were considering buying more properties, two thought that they would be able to negotiate a lower sales price as a result of the stamp duty increases, but all the rest felt that this was unlikely and that they were therefore likely to reduce the rate at which they bought properties. The stamp duty cost has to be paid upfront so cannot so easily be included in a mortgage calculation as an increase in house prices would be, meaning that landlords need to find a larger deposit in order to fund new purchases, if they are to avoid higher loan to value ratios.

Just need to get a bigger deposit, it will take me longer – I will buy properties less often.

(11 properties, Midlands)

It's an extra £1,800 to £2,000 per property. Not only do we have to find the deposit and the solicitors fees, now we have to find another £1,800 to £2,000 for another fee on top.

(13 properties, North East)

I'm not going to start going crazy and buying 10 houses when I've got the extra 3% on each house, why should I give that money away?

(12 properties, North East)

One (medium sized) landlord planned to refocus on commercial properties instead of residential as a result of the stamp duty increases, and this trend was also picked up upon by one of the stakeholders (a lender), who were aware of landlords refocusing on commercial property.

The biggest impact was undoubtedly felt by those who were in the midst of a major programme of buying properties, with finely balanced business plans:

We could not understand why the Government put this tax on us. The impact on us is huge.... My target was to buy 800 new flats last year and we bought 111, largely because of this new tax.

(320 properties, London and the South West)

Interviewees were asked whether the stamp duty increases deterred them from managing their portfolios by buying and selling stock, but landlords were already of the view that it was rarely worth selling in order to buy another property unless there was a very strong reason to do so. A commonly given reason was the heavy impact of Capital Gains Tax [CGT] when a property is sold. They felt that the additional stamp duty would make little difference in this respect.

Some of the stakeholders said that the increase in stamp duty would push rents up, though landlords themselves did not raise this issue. The more commercially minded landlords were already charging what they thought the market would bear for rents, and were aware that this wasn't going to change because of stamp duty changes; whilst the less commercially focused landlords did not feel directly affected by the stamp duty changes because they had already bought their properties. A couple raised the possible impact on potential sales price if they sold to another landlord, reducing the incentives to consider selling a tenanted property to another landlord. One of the institutional landlords was concerned that the stamp duty surcharge could have an impact on their business plans, even for properties that they built themselves, as it may affect subsequent resales.

Offsetting mortgage interest

The changes to mortgage interest tax relief were causing the most alarm among private landlords, but were also the least well understood.

Company landlords are unaffected and can continue to count mortgage interest as a tax deductible business expense even if their employees and/or directors pay higher rate tax. This meant that the large institutional investors were unaffected. The other 26 landlords all owned at least some of their properties as individuals – until recently, 23 of them had owned properties only as private individuals (in some cases jointly with business partners or spouses). Three had a mixed portfolio with a mixture of individual and company ownership, for historical or business reasons. However, a further four of the other 23 landlords had recently set up a limited company, or were in the process of doing so, in order to avoid being affected by the changes to tax. These were mostly medium sized landlords, all with between three and 100 properties. Some planned to move all their properties into the limited structure; others would instead use it for new purchases, as there was limited borrowing on their existing stock. Moving to a company structure is not necessarily straightforward, especially for landlords with substantial borrowing, as the criteria for borrowing from banks differ for companies and individuals with buy to let mortgages. One of the landlords who was moving to a company structure said that he had sold ten properties to reduce his borrowing, which he said was a direct response to the tax changes.

Of the remaining 19 landlords, eight were unlikely to be affected by the reforms: six had no mortgages on their rental properties, one expected to have paid off the mortgage very soon and one did not declare his rental income and therefore paid no tax on it.

Of the ten landlords who could potentially be affected, only three appeared to have a full understanding of the implications on their financial situation. Two of these thought they could cope by reducing their borrowing or accepting a lower return, or even a loss, on their property, because they had other sources of income.

The third was a landlord run as a partnership with three partners owning, between them, 65 properties in the London area, mostly held in their own names (i.e. not through a company structure). The business had started 30 years ago, but they had re-mortgaged extensively to grow the business and now had loans for around 55% of their total value of their assets. They had, until recently, been letting furnished properties and making “full use of the very generous wear and tear allowance”, the abolition of which had already hit their profits. The high level of mortgage borrowing, and overall size of the business, meant that the gross rental income was very much higher than the profits, and they had calculated that the increased tax bill would be substantially higher than their actual profits, after paying mortgage interest, leaving their business unviable. They reported that they could not easily move properties to company ownership because of capital gains tax due. They planned to use a combination of raising rents where viable, reducing expenditure on maintenance; selective selling of properties, and trying to revive a building aspect of their business to offset the losses.

Two landlords were aware that their income would be affected, but lacked any real knowledge of the degree of impact:

I'm not quite sure. There'll be more tax to pay I guess. My accountant will look into the details.

(12 properties, North East)

I will go onto a spreadsheet once the time comes, because I'm obviously locked into each of the mortgage deals that I've got, none of them are coming up until October this year. I don't need to think about it until then because there's nothing I can do.

(3 properties, North East)

The remaining six landlords all thought they would be unaffected because they did not currently pay higher rate tax:

It won't affect me as much because I'm not a higher rate tax payer.

(8 properties, North West, all bought with mortgage finance)

We shouldn't be affected, because we don't make a whole lot of money out of the property.

(8 properties, North East, all bought with mortgage finance)

However, the figures they gave suggested that some would be affected, despite not being a higher rate tax payer. If a landlord's *gross* income, including rent, is still below the higher rate tax threshold, they will be unaffected by the reforms. But those whose *profit* (and any other income) is currently below the higher rate tax threshold but whose rental income without a deduction for mortgage interest takes them over this threshold, will be affected by the reforms. Our research found at least three examples from this group in particular who were unaware that they will be hit but gave figures suggesting that they likely would be. For

example, one interviewee with a single property in London stated that he would not be affected as his income (from employment as well as his property) was just below the higher rate tax threshold. However, he gave figures of £18,000 rental income and £12,600 in mortgage interest payments per year. In addition to the 20% tax he currently pays on the £5,400 profit (£1,080), he would be likely to get an additional tax bill of around £2,500. Two other landlords each had eight rental properties, all mortgaged, and gave examples of rents which would be likely to generate an annual income in excess of £45,000, despite generating low overall profits, once mortgage finance was offset in full.

Overall, the changes to mortgage interest tax relief have a very diverse effect on landlords; many are completely unaffected – if their net income from rents will still leave them below the higher rate tax threshold, or they have no mortgage finance. Company landlords are unaffected, and converting to a company structure offers a way to avoid the extra tax for many landlords who might otherwise be most affected. A small number of landlords are likely, nevertheless, to be badly hit by the additional tax to the point where business viability is threatened and selling at least some stock is likely. The expert interviewees all considered that this was more likely among medium to large landlords (with 11 or more properties), those who were highly geared, and those in the north of England where profit margins were small and capital gains tax less of a deterrent to selling.

Changing economic conditions

Interest rate rise

The impact of interest rates on the landlords interviewed was very mixed – many of the smaller ones in particular would be unaffected as they did not have mortgages. Landlords were, in the main, aware that an interest rate rise is likely at some point. Some had fixed rate mortgages offering protection in the short term. Around half of the interviewees had become landlords within the last ten years, so had grown their businesses at a time of historically low interest rates. Most of those with mortgages were unable to put a figure on what level of rise they would be able to cope with:

I don't know. I would have to do the maths, because I don't think it's quite as simple as putting a percentage on it, because the amount you'd have to repay would depend on the balances that were outstanding on the mortgages at any one point.

(2 properties, North East)

I suppose we could go a couple of percent, because we've benefitted from the very low rate of interest. But I don't know, without sitting down and looking at the figures, and without knowing exactly what they would go to, but unless they rose to really ridiculous amounts then we could still continue.

(6 properties, Midlands)

Those who could give an estimate varied between a half a percent and 17 percent in terms of what would be manageable:

I wouldn't want to see more than 1%.

(12 properties, North East)

I've got a sliding calculator on my spreadsheet which calculates my whole portfolio if the base rate goes up by quarter percentage points, so I know exactly where I'm at, at each point. I believe I could cope with up to a 4% rise before it wouldn't be worth it.

(3 properties, North East)

Some landlords said that they would raise rents in order to cope with higher interest rates. This was true even for some of the more commercial larger landlords who were already charging what they considered to be a market rent and aware that they could not just increase it to cover increased costs; they also felt that increases in interest rates would, however, lead to an increased demand for renting, as households found it harder to afford homeownership, which could increase market rents:

Increased interest rates could make mortgages more expensive therefore people will rent and this may help us. Also, prices might fall.

(320 properties, London and selected cities)

Increased interest rates would push up rents partly because of costs and partly because of higher rented demand.

(1,200 properties, London)

Several landlords said that they would try to reduce their borrowing if interest rates rose by not buying any more properties until they had paid off more of their debts. This included both large institutional investors and smaller landlords.

Changes to mortgage lending

Most landlords were not too concerned about changes to lending practice – smaller and medium sized landlords typically grew their portfolios in opportunistic fashion. If mortgage finance was available they would buy a new property; if it wasn't, they wouldn't, but this would not affect the overall viability of their business model:

It would take me longer to buy the next property as I would need longer to get the deposit together.

(11 properties, Midlands)

We're always borrowing.... After we do the renovation and we get the new valuation then we would borrow against it. So we'll continue to do that.... Most of the time we can already work out what we can re-finance for after we'd done the work. So if that was to change we'd have to change our business plan accordingly.

(50 properties, Midlands)

One of the larger institutional investors, in contrast, was aware that if interest rates offered a higher return than their rents for a significant period then the opportunity cost of investing would mean that they would scale down borrowing and not grow their portfolio, instead investing their money (such as pension funds) in other ways.

Falling rents

Landlords were asked how they would respond to a fall in market rents. Around a third of them did not answer the question and stated instead that they did not believe that this would happen, so did not need to have a plan. These were mainly smaller landlords and were spread across all parts of the country. Some gave specific reasons why the rent on their property would not fall, or believed that they were already charging a sub-market rent:

I don't think the rent on that house would fall and think they're paying a low rent already. Rents in Shrewsbury aren't very high, and there's soon to be a University campus nearby so I don't think it's very likely.

(1 property, South West)

I don't really see rents falling significantly in London: any Brexit effect will probably be offset by continuing internal migration to London.

(1 property, London)

Of those who did consider the possibility of rents falling, most considered that they would simply make lower profits, but that this would be manageable:

I'd be disappointed, obviously, from purely a mercenary viewpoint, but it wouldn't greatly affect me because the ratio between what I have to pay, of £60 pay, and what I get, £625, I think the rents would go down 5, 10%, it wouldn't go down by half, I know that, there will always be demand.

(9 properties, Midlands)

I'm primarily interested in capital appreciation, so I wouldn't really be bothered if I made a small loss each month between the outgoings on the mortgage and the net income from rent.

(1 property, London)

I wouldn't really be affected by a fall in rents, because I'm low geared – it would probably be a good thing, for younger people if rents fell. It might happen, given the rate of building flats in London at the moment.

(5 properties, London)

Falls in house prices

This was one area in which all landlords, small and large alike, concurred. Almost without exception, they stated that they were in business for the long haul, and would not sell in response to falling prices:

Live with it. It's the way of the world. If there's a fall in house prices that will only be for so long. If you're in for the short term it can have quite an impact, but I'm not.

(1 property, London)

Seeing as we're not considering buying or selling, it doesn't really make very much difference.

(5 properties, North East)

Well it's being rented, so to me it's not a consequence, it's only a consequence if I decide to sell the property, which would be disappointing, but that's life you know, it fluctuates. As long as you stay in there long term I think properties will always go up, generally speaking.

(1 property, Midlands)

I intend to keep the property to retirement.

(1 property, East)

A few of the medium and large landlords saw a fall in house prices as an opportunity to purchase more properties:

That would be fantastic! We'd buy at a lower price. Because we try not to sell anyway, if we can help it.

(15 properties, Midlands)

It would be an opportunity in terms of acquiring more, that's actually our business model, we don't really sell.

(50 properties, Midlands)

The combined effect of tax changes and economic changes

The combined effect of the different changes to taxation along with economic uncertainty do however contribute to make being a landlord less attractive than it was previously, though this was more likely to hit plans for expansion than it would for selling stock. Changes in behaviour are hard to attribute to just one change though, as they very often arose as a result of more than one factor occurring:

I was looking at [buying a property] but a combination of the hike in stamp duty and then the fall-out of Brexit closed that door totally.

(10 properties, London)

I would say it's quite a hefty impact overall and it would make us consider not buying any more to be perfectly honest, I'll be holding back, I'll be looking for other opportunities.

(5 properties, North East)

Some landlords said that they would raise rents to cope with increased tax or hikes in mortgage interest rates. Others, however, reflected that they were already charging market rent, and that there was therefore little potential to increase rents even if their costs as landlords did increase. A few landlords pointed out that taking tenants in receipt of Local Housing Allowance was incompatible with raising rents to cope with tax or economic

changes, especially when combined with the introduction of Universal Credit and the risks associated with no longer receiving direct payment of benefits:

We may find there are some people who are... pocketing money again and we're going to have to put them on the street.

Overall, it means more tax, less housing and I have been forced not to accept benefit tenants.

(49 properties, North East)

One expert and two landlords also raised concerns that criminals or landlords who did not declare their income for tax purposes would move into the sector. Two interviewees admitted that they did not declare their income and many more landlords were unwilling to speak to researchers, suggesting that this could be more widespread.

The NLA also raised the more general issue of landlords exiting the sector because of a growing lack of confidence in the government to support the sector:

Our members lack confidence the tax system will stay consistent, for instance around capital gain tax reliefs.

While many of the landlords interviewed would be affected by the reforms, some did share these concerns:

It is important to stress about the wrong messaging from the stamp duty surcharge and regulation, it is suicidal. It's the wrong way to go about it if the Government wants to build more homes with institutional money. We are in a positive place with investors – do not ruin it Government!

(1700 properties, London and South East)

They also pointed out that the changes to mortgage interest tax relief would exacerbate the impact of any rise in interest rates as many landlords would only be able to offset half the rise against their profit before tax.

4. Conclusions

The overall conclusion of this qualitative research is that the landlords interviewed showed a strong commitment to the private rented sector and are not likely to leave in a hurry. The reasons that some gave for considering sale included personal circumstances, such as retirement. Falls in house prices, or reduced profits, are unlikely to make many sell up. The main impact of the recent tax changes is likely to be to reduce the speed at which the sector grows, rather than cause a sudden exodus of landlords. Landlords appear, overall, to respond to changes in the economic or fiscal environment by changing the rate at which they purchase new properties, rather than sell existing stock.

A large number of landlords have been in business only in times of low interest rates, and for some with mortgages, a significant increase in interest rates could pose difficulties potentially leading them to sell. Few landlords thought they were likely to sell up, though some appeared to consider that rises in interest rates, falls in house prices or falls in market

rents were simply things that they did not believe would occur – suggesting an optimistic and possibly naive approach.

Of the three tax changes explored, our analysis suggests that only the changes to Stamp Duty were universally well-understood. Landlords are clear that this has reduced their appetite for growing their businesses, but the impact on buying and selling existing stock has been minimal. The abolition of the wear and tear allowance, whilst not fully understood by many smaller landlords was, overall, considered to be a reasonable reform and not likely to cause a major shock to the sector or large-scale holes in business plans. The impact of the mortgage interest tax relief, however, is very varied across the sector.

Whilst the majority of landlords will be unaffected, or minimally affected, this research suggests that a small number of highly-leveraged landlords with slim profits but high overall rental incomes will see a severe impact, meaning that their tax bill is larger than their profit. The extent to which this results in those landlords leaving the sector is hard to predict, not least because conversion to a company structure offers a way of avoiding the impact of this tax. This research suggests that landlords who are fully aware of the implications of this tax reform are already in the process of converting to a company structure to avoid it.

On the one hand, this may help alleviate the situation of landlords with otherwise unsustainable businesses and thus prevent them leaving the sector; on the other hand, if landlords all convert to company structures, the intended impact of the tax (to raise money and/or weight the market in favour of owner-occupiers rather than landlords) will be negated. Several of the landlords in this study already owned properties both as an individual and as a company, suggesting that there will be little change in how the stock is managed if it is individually or company owned.

It is also clear from this research that the full extent of the tax changes would not be seen for some time especially in relation to the mortgage interest tax changes. Moving from a system where profit is first worked out, and then tax applied, to a system of calculating gross income and then applying a 'tax relief' is fundamentally more complicated, and this research suggests many landlords do not understand the new system. The government's efforts to phase in this reform, to give landlords time to adjust, may be somewhat undermined if landlords fail to understand what tax they are being expected to pay or how this is calculated each year.

This research also suggests that the issue of how landlords sell tenanted properties, and what happens to those tenants, is not well understood. As the sector has grown, there are growing opportunities for tenanted properties to be sold to other landlords, avoiding the tenant losing their home. This market does not, however, appear well understood or developed and landlords' lack of understanding of this option may deter them from considering it. Landlords are also more likely to evict a tenant in order to sell if they need to do so urgently – many of the landlords we spoke to were instead taking long-term decisions and were often able to sell properties as they became vacant. This also offers a means by which evictions can be avoided, so long as the pressures on landlords to sell are consistent and not unpredictable.

The other key conclusion from this research is that the private rented sector is owned and managed by a very diverse group of landlords. More than half the stock is owned by landlords who own just a single property – and this group is particularly poorly understood,

yet they exhibit some distinctive styles of buying and selling properties – often becoming a landlord accidentally in the first instance, or purchasing a property near to their home as an investment, and selling only when there is a need to free up cash for personal reasons. These landlords are likely to respond differently to both tax and economic changes. Professional and semi-professional landlords managing small portfolios are different again from the very largest institutional investors, many of which are new and fast growing and whose decisions are fuelled by an appraisal of rental income against purchase price and comparisons with other investment opportunities.

These differing types of landlord are likely to respond in different ways to economic and fiscal changes, though overall it would appear that decisions over whether to purchase new properties are much more easily influenced than decisions to sell, which are not made lightly.

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