



Department for  
Communities and  
Local Government

# Review of the barriers to institutional investment in private rented homes

© Queen's Printer and Controller of Her Majesty's Stationery Office, 2012

*Copyright in the typographical arrangement rests with the Crown.*

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or e-mail: [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

This document/publication is also available on our website at [www.communities.gov.uk](http://www.communities.gov.uk)

Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government  
Eland House  
Bressenden Place  
London  
SW1E 5DU  
Telephone: 030 3444 0000

August, 2012

ISBN: 978-1-4098-3624-7

# Review of the barriers to institutional investment in private rented homes

## Foreword

I have pleasure in submitting my report summarising the results of the review of the barriers to institutional investment in private rented homes.

We have kept this report short and to the point. We are satisfied that the rented housing sector offers potential investment opportunities of interest to institutional investors. There has been some activity in the sector, but real momentum is inhibited by constraints affecting the supply of stock, by the treatment of rented housing schemes under the planning framework and by the need to create greater confidence among investors in the availability of good projects showing acceptable, secure returns. We have made a limited number of recommendations focused in these areas, which we accordingly submit for consideration by the Government.

In conducting the review I have been greatly assisted by my review group, consisting of:

Vidhya Alakeson, The Resolution Foundation  
Tim Brown, de Montfort University  
Graham Burnett, Universities Superannuation Scheme  
Ian Fletcher, British Property Federation  
Nick Jopling, Grainger plc  
Victoria Mitchell, Savills and Berkeley Group  
Nick Salisbury  
Peter Vernon, Grosvenor

They have been most generous with their time, and I would like to record my appreciation and thanks for their advice and assistance, and for the unfailing support I have received from officials at the Department for Communities and Local Government.



**Sir Adrian Montague**

# Background

1. The Government's Housing Strategy, published in November last year, set out the government's plans to boost housing supply. It recognised an increasingly important role for the private rented sector both in meeting people's<sup>1</sup> housing needs, and in supporting economic growth by enabling people to move to take up jobs elsewhere and to respond to changing circumstances.
2. The private rented sector has grown rapidly in recent years and now houses 3.6 million households, compared to some 2 million in the early 1980s. The sector is very diverse - some of those households are students, or young professionals but around a third are families with dependent children. And around 20% of households in the sector have been at their current address for more than 5 years. There are a significant number of people making long term family homes in the private rented sector.
3. At the same time, there have also been steady improvements in the quality of rented homes. For example, in recent years, privately rented homes have become as energy efficient on average as owner occupied homes, although the sector remains hugely varied.
4. Much of that growth and improvement in quality has been driven by individual landlords with small portfolios, who represent the majority of the sector. There are only a relatively small number of larger landlords – only 1% own more than 10 properties<sup>2</sup> - and, critically, growth in the rented sector has generally not contributed to the supply of new housing<sup>3</sup>.
5. Housebuilding is a major contributor to economic growth. Housing construction, repairs and maintenance have a direct impact on economic output - an average 3% of GDP in the last decade<sup>4</sup>. Housing construction also supports more jobs than investment in many other sectors of the economy due to related activity. Every £1m of new housing output supports 12 additional jobs - 7 directly and 5 indirectly - per year<sup>5</sup>. It has been estimated that, for every £1 invested in the construction industry, £2.60 is generated elsewhere in the supply chain.
6. So an increase in housebuilding is needed not just so that more people can meet their housing aspirations, but also to support wider economic growth. But there is a widening gap between housing supply and household growth. In 2009/10, there were 115,000 new build housing

---

<sup>1</sup> English Housing Survey – Homes Report 2010. Published by DCLG, July 2012

<sup>2</sup> Private Landlords Survey 2010. Published by DCLG, October 2011.

<sup>3</sup> English Housing Surveys for 2008-2011

<sup>4</sup> ONS Construction Output

<sup>5</sup> Housing Strategy supporting brief

completions in England<sup>6</sup>. Meanwhile, the most recent household projections suggest that the number of households will grow by an average annual 232,000 per year until 2033<sup>7</sup>. At the same time, mortgage lenders have become more risk averse since the crisis— mortgage lending across the board (including to first time buyers) has roughly halved since 2006-07<sup>8</sup>.

7. Government is working to tackle constraints on mortgage finance through a range of initiatives. But, even if mortgage finance is only constrained for a short period, imbalances between supply and demand for housing make it critical to develop new models - models in which housebuilding does not rely solely on demand from owner-occupiers, and which offer a greater variety of options for the increasing number of households who are renting their home. Also, for housing benefit claimants, a material increase in rental stock in areas of high demand could make a real difference to their ability to access good quality accommodation.
8. Government, therefore, commissioned this review to consider the potential for attracting large-scale institutional investment into new homes for private rent – a model of investment which is much more prevalent in other countries, and in some niche markets in the UK, like student housing. The government’s terms of reference for the review are set out in Annex 1. Based on this, we focused on two key questions: Have the changes previously introduced by Government (changes to the stamp duty levied on bulk purchases and to make REITs work better for residential property) gone far enough to generate significant new flows of investment? And, if not, what can be done to accelerate things?
9. We issued a call for evidence in January 2012 and received over 60 responses. We also met a very large number of individuals and organisations representing investors, house builders, registered providers of social housing, regeneration bodies, local authorities. All respondents to the call for evidence and those we met are listed in Annex 2 to this report.
10. The evidence that we found shows that the changes in stamp duty and in REITs, whilst positive in their impact, have not of themselves stimulated an incremental flow of institutional investment into new housing built specifically for rent. Many of those who responded to the call for evidence and whom we met called for further Government intervention to address what they described as a case of market failure.
11. The remainder of this report sets out some of that evidence, describes the barriers that we found, and sets out our recommendations for overcoming them. In summary, we believe it is essential that the

---

<sup>6</sup>[www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/housebuilding](http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/housebuilding)

<sup>7</sup> *Household Projections, 2008 to 2033, England* DCLG 2010

<sup>8</sup> Council of Mortgage Lenders data

Government clearly signals the importance it attaches to the expansion of the “build to let” market. We believe the Government should give tangible form to this by encouraging local authorities to make more positive use of existing opportunities under the planning system to promote private rented schemes, by reaffirming its commitment to release public land for build to let projects and through providing carefully targeted financial support to the sector with a view to levering in additional private capital. In particular, we should recognise the key role being played by local authorities in this area. Not only are they a central cog in the process in their role as planning authorities, but many are generally supportive of private rented schemes and some are pursuing schemes of their own.

# Evidence

## The potential

12. The evidence we heard made a strong case that large-scale developments specifically designed for private rent (or with a substantial private rented element) could deliver real benefits for communities and for tenants, and could also be an attractive investment proposition.

## The potential for communities

13. Local authorities, registered providers, investors and developers all presented to us examples of specific schemes which would meet identified needs in local areas, as well as contributing to the broader delivery of new homes. Schemes were generally highly tailored to local circumstances, but there were a number of common features.
14. The most common feature was the potential to offer **longer-term rented homes**. Some proposals included the potential to offer longer tenancies (perhaps with an index linked rent), but most simply offered tenants the security of knowing that the property would be available to rent long-term. And some local authorities saw new investment in high quality private renting as an additional lever to encourage landlords to improve the quality of existing stock and its management.
15. Some schemes also aimed to deliver **a better service to tenants** including, for example, a dedicated repairs services on site and a concierge. This “renting plus” model builds on the features of private renting which tenants already find most attractive. It was a particular feature of schemes which drew efficiencies from whole-block management, where all of the homes in a building were rented from the same landlord.
16. Some financial institutions we consulted emphasised the importance they attached to the development of schemes that involved **purpose-built accommodation to a high standard of construction**. As potential long term owners of the completed developments they said it was in their interest to assure tenants of the quality of both the property and the ongoing management and maintenance regime, including for example specific provision for periodic refurbishment of the property. And new build accommodation will also offer the potential for significant sustainability benefits.
17. All of the schemes which were already making progress were doing so because they were **responding to the identified needs of local communities**. In some areas, the development of a high quality rented sector was a priority because the existing offer was particularly poor. In others, local authorities wanted to encourage good quality new build housing to let, because they recognised that fewer people could buy in

the current market. They were looking for more flexible tenure options, with the potential for properties to become owner-occupied if market conditions changed. In another area, the development of high-quality private rental was an integral part of an inward investment strategy targeted specifically at employers.

18. In some areas a component of private rental was **helping to unlock stalled sites**, taking account of current demand for private rental rather than home ownership. In some cases, the focus is on the traditional approach of re-negotiating existing planning obligations. However, elsewhere, more innovative local authorities and their partners are using early build out of housing for private rent to generate income streams and early sales to large scale professional landlords in order to unlock the remainder of a given site. And developing the early phases of large sites for renting enables a new population to establish itself quickly and promotes street level activity and economic growth.
19. These are different solutions for different areas, but they all demonstrate that large-scale investment in rented housing can have a positive role to play in responding to local needs. The following case studies demonstrate both what can be achieved and what the longer-term aspirations might be.

#### **Manchester City Council and Greater Manchester Pension Fund Housing Investment Fund**

The Manchester City Council has a strategic objective to grow its working population and to rebalance the housing offer to a more market orientated, higher value home ownership model. However, in recent years home ownership has become increasingly difficult to deliver in any quantity. The City Council has therefore re-focused the offer on a mix of higher quality market rent and homeownership products such as equity share which in their nature create a long term interest in the development. The City Council is also prepared to invest some of its land assets into achieving this objective.

This longer term interest creates the opportunity to create a new investment proposition. Greater Manchester Pension Fund has expressed a desire to invest more in the Greater Manchester area and to consider investing in residential investment alongside its existing commercial property developments. By combining forces with the City Council, a housing investment proposition and model has been developed and soft market tested with a number of housebuilders and registered providers.

The concept is for two investors, one with land (the City Council) and the other with cash (the pension fund) to combine to procure a housebuilder and a managing agent to develop a market-driven mixed-tenure development across a number of sites which returns a blend of sales and rental income over a period of time. The income derived from the investment is sufficient to provide a level of return to both investors with the pension fund taking a priority return and the City Council recovering its land values as a second priority. The Homes and Communities Agency have also committed to investing one of their remediated sites. The pension fund and the City Council are in the final stages of agreeing a Memorandum of Understanding and will be proceeding with procurement over the next 12 months.

## **FIZZYLIVING**

FizzyLiving is a subsidiary of Thames Valley Housing Association, established to procure a substantial portfolio of new apartments which will be rented to young professionals.

FIZZY buildings will provide around 100 one, two and three bed apartments, designed and specified for a target market left behind by the scarcity of new developments and the cost of finance. All apartments will have a high standard of specification, and the buildings will all have a building manager, providing a quality service.

FIZZY buildings will be adjacent to direct transport links into the City, West End or Canary Wharf, in safe environments with good local amenities. Rents will be reasonable, and longer term tenancies will be welcomed.

The first two FIZZY buildings launch this year, at Canning Town and Epsom. Initially FIZZY will grow to around 1,000 apartments in Greater London over the next couple of years, with an intention to expand into the South East and then Nationwide.

Thames Valley Housing Association have provided seed capital to buy the first two buildings, and are now sourcing debt and equity to roll out the brand.

Vermillion, Canning Town



Epsom St



## **Building a future for renting – Grainger’s vision of Build to Rent**

As private renting continues to grow, the products that housing providers offer must develop and mature to meet the needs of the market. Grainger’s Build to Rent initiative is a vital component of its vision for the future provision of high quality rental housing in the UK.

Build to Rent developments will have a minimum of 100 units, providing the critical mass necessary to support special amenities such as a concierge, small business centre, café or communal / community space. This scale and concentration will allow for greater economies of scale and operational efficiencies. In turn, these efficiencies will support stronger net income yield for investors.

Grainger believes that locations providing long term prospects for tenant demand are the best place for Build to Rent to work. In London this will often mean targeting regeneration areas, as prime central locations have high land acquisition cost, which can translate into unaffordable rents. All chosen locations will need to have strong transport links, ensuring fast and easy access via public transport in and out of city centres.

Tenants in Build to Rent developments will have a secure and stable place to call home. They will know who their landlord is for the long term. They will be able to renew their tenancy agreement year to year, but they won’t need to tie themselves into contracts for multiple years. Rent levels will be targeted around 30 to 40% of average local net incomes, and a high standard of property management will be provided.

Local authorities encouraging such schemes will benefit from a supply of quality housing, managed by responsible landlords, for residents that are unable to or do not want to commit themselves to home ownership. This beneficial addition to local economies and housing markets reflects the changes taking place in society and the wider economy.



### **Modern liveable private rented homes for Hull**

Hull's neighbourhood renewal and growth strategy focuses on key priority areas where there are compelling opportunities to provide a mix of property types and to deliver vibrant and sustainable property markets. A key to an area's success is diversifying tenure alongside the delivery of wider place making, including facilities and green space. For success it is important to achieve a quick build programme whilst delivering a range of housing options. The current local economic climate makes selling houses at any scale challenging.

Within the Ings area of east Hull the Council is working alongside one of its lead registered providers, Chevin Housing Association, part of the Together Housing Group, where it is looking at the potential to deliver well managed, integrated and planned privately rented properties in partnership with a lead developer and finance partner.

An integral part of these plans is to deliver a balanced housing market offer sitting alongside market sales and affordable rented homes. This is especially important for Hull as currently there is an undersupply of quality, energy efficient private rented homes which offer a genuine alternative for those who aspire but are unable to purchase their own homes. The demand is expected to increase as the city grows into the regional and national hub for renewable energy production.

### **The potential for investors**

20. Evidence to the review also underlined the potential attractiveness to investors of large scale developments of rented homes. Many investors drew comparisons with commercial property, but challenged the "traditional" view that residential investment was a less attractive proposition. Some of the key factors are set out below.
21. **The underlying fundamentals are strong.** The market for privately rented housing is generally strong and growing, and is underpinned by pronounced imbalances between supply and demand. Schemes are starting to emerge and there is significant pent up demand for rented housing in the years up to 2020, at least<sup>9</sup>
22. **There are strong synergies with liabilities.** Rents in the private rented sector have tended to rise roughly in line with real average earnings<sup>10</sup>. This is widely seen as an excellent match for liabilities arising in pension funds. Large-scale portfolios of rented homes can also offer a spread of risk through investment in a range of locations<sup>9</sup>.
23. **There is potential for diversification** – returns from UK residential investment offer a different profile to commercial property or equities, and therefore offer existing portfolios good diversification opportunities<sup>10</sup>. And overseas investors see the private rented sector as an inflation and currency hedge. The private rented sector also offers the advantage of multiple exit strategies, including break-up, aggregation, flotation, REIT status or sale to other investors.

---

<sup>9</sup> Richard Ellis and AREF/BPF/IPF responses to Call for Evidence

<sup>10</sup> Grosvenor Group Ltd, Richard Ellis, AREF/BPF/IPF responses

**24. Yields could meet investors' requirements.** The evidence we received challenged the perception that yields in the sector would always be insufficient to attract investment, particularly when compared to commercial property. Some respondents highlighted the strong total return performance of residential over the last 10 to 20 years<sup>11</sup>. As the chart below demonstrates, returns on residential property have totalled 9.6% on average over the last 10 years, significantly above comparable figures for commercial property which range from 7.3% to 5.7%.

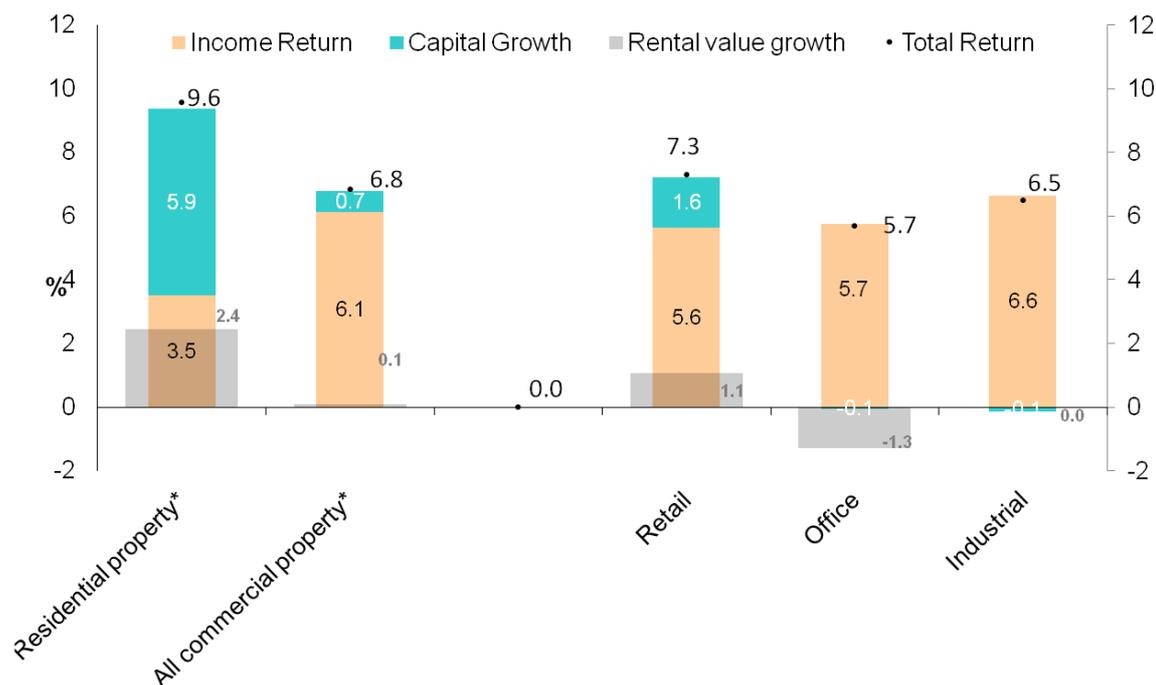


Table 1: Regional residential market investment performance: 10 years to end 2011 (Total return, Income return, capital growth and rental value growth % pa)<sup>12</sup>

**25.** They also suggested that a more nuanced approach to the assessment of income returns (as opposed to capital) which took account of the impact of increasing capital values and voids and focussed outside prime central London might point to higher actual yields than current analyses would suggest<sup>13</sup>. But it remains the case that a significant part of investors' returns from the residential sector have tended to come in the form of capital growth (on the eventual sale of rented assets to the owner-occupier market), and to bring pure income returns into investors' target horizons it will be necessary to bear down on land, construction and management costs.

**26. Investors were attracted by the stability of the regulatory framework.** Alongside stable returns, respondents also drew our

<sup>11</sup> Grosvenor Group Ltd and IPD responses

<sup>12</sup> Residential market performance sourced from the IPD UK residential market let index. Commercial property performance sourced from the IPD UK quarterly property index

<sup>13</sup> This and subsequent box all taken from IPD response

attention to the importance of the stability of the regulatory framework for renting over the last 20 years. Equally, they warned of the dangers to the attractiveness of the sector were that stability to be undermined. In the 1970s rent controls and restrictions on regaining vacant possession caused institutional interest in the sector to evaporate, and strong Government endorsement of the current status quo in these areas would help to bolster the market.

### **The potential for developers**

27. The private rented sector has the potential to engage a broad range of developers. Local authorities are bringing forward private rented schemes (sometimes as part of mixed-tenure schemes), and we also heard from housing associations, from private residential landlords and developers, from international construction companies and, to a lesser extent (recognising that their primary focus is on the owner occupied market), from housebuilders, all of whom were starting to show real interest in the potential build to let market.
28. The potentially important role of housing associations deserves special mention. Among the larger associations, there is starting to be considerable interest in market rent developments as a natural complement to their existing activities in affordable housing. The associations have the potential to become key players in the development of bespoke private rented schemes, as the balance sheets of at least the strongest among them will support standalone capital raising to finance developments. In addition, their existing affordable housing portfolios give them both asset management expertise and a strong platform to offer a professional service to tenants.

## The barriers

29. Despite significant interest for several years, this potential has not translated into large-scale investment. The evidence we heard pointed to several core barriers.
30. In spite of the potential outlined above, **the market isn't currently offering what investors want** – and different investors want different things. Some institutional investors view residential property purely as a financial asset and seek to invest in the stable long-term income returns offered. In general, pure income investors of this type do not assume development risk and would not, therefore, commission new build homes.
31. There are other financial institutions, however, that seek a close involvement in the development process, because they want to prescribe and monitor quality both in the build and in management standards. They see themselves as owners of residential units as a core part of a long-term portfolio.
32. But the strength of the owner-occupier market, the lack of developments of scale, and the challenges to net yields have constrained the range of opportunities available to investors to invest in new schemes. Linking institutions with the development pipeline is vital to boosting supply, perhaps through guaranteed take-outs – that is developments which are fully built out and let - allowing developers to accept a lower return for de-risking their output.
33. **Novelty is also a barrier.** Whilst individual private rented schemes have been a feature of the market in a small way in the past, the extent of activity in the market has not generated a steady flow of schemes or the emergence of a generally accepted body of practice or market benchmarks. Several investors we spoke to had pulled back from investing because they were unwilling to be the first mover in an expansion of the sector. This was particularly true of overseas investors, who were unwilling to invest when UK investors were holding back. At the same time, new entrants tend to seek a premium to compensate for the apparent novelty of the sector and the lack of operational comparisons, which puts further pressure on yields. Even where this is not the case, **doubts remain about yields**<sup>14</sup>.

---

<sup>14</sup> IPD response

### Yields – the concerns

- Capital vs. income – because of the strong values prevailing in the owner-occupied market, a high proportion of investors' returns on residential rented properties has tended to be delivered as capital growth rather than as rental income, with capital growth delivering an average of 5.9% annually over the last 10 years compared to 3.5% in income return (defined as net rent after management costs).
- By contrast, income returns are high in commercial property investment, but capital values tend to decline over the long term.
- Investors analyses have tended to be skewed by property holdings in central London where, because of the high capital values, income yields are low.
- High management costs for residential (up to 30%) compared with commercial (c. 5%) further depress yields which are calculated as rental income net of management (but not, as noted above, of voids).
- We were given a range of figures for yields that would be acceptable to investors. Much of the information given to us was commercially confidential. But there seemed to be a reasonable consensus that the base historic net yield of 3.5% p.a. would be too low to prompt much investor appetite, without the boost to total returns from capital appreciation (which implies sale to owner occupation within a reasonable period after acquisition).
- A change of paradigm to a long-term residential investment market dependent only on income returns is therefore likely to require higher rents, or lower land, construction and management costs, or some combination of all of these.

34. A large number of people raised concerns about **the planning system and the sale of land**. Some of the issues were common to all housebuilding – there was a strong feeling, for example, that public land was not being brought to market quickly enough. But some were specific to building rented homes – for example, it was felt that some public landowners were still overwhelmingly motivated by the highest possible sale value (whether or not that was achievable in the current market) and were not interested in more innovative uses of land, including joint ventures or deferred receipts. Having said that, there were some good examples, including where local authorities were investing their own land in joint ventures.

35. In principle, the planning system does not distinguish between private rental and owner occupation. But, in practice, people told us that it was generally assumed that homes which were not specifically set aside for affordable housing would be sold to owner-occupiers, or perhaps to small buy to let investors. This assumption is built into **calculations of the value of land**, including when assessing planning gain for the purposes of determining section 106 and Community Infrastructure Levy agreements.

36. Respondents said that, in assessing local housing markets, local authorities generally do not distinguish between demand for rented accommodation and demand for home ownership. Many people felt strongly therefore that the Government needs to give a clear lead to local planning authorities to encourage them to recognise the role of private renting, and the different economics of developing homes for rent, within the context of a full understanding of local needs.

**The price of sites for housing for rent is driven by values in the owner occupied market**

- The cost of producing housing is a factor of construction costs, s.106 obligations, financing costs, profit for risk and land price
- Land price reflects the net residual value projected by the developer after providing for construction and financing costs, s.106 obligations, and profit against the estimated sales value of completed stock
- All housing other than social housing can be sold to owner occupiers by the developer – there are no restrictions on that
- The result is that all housing land prices tend to be fixed according to the price of owner occupied housing
- Developers wishing to build housing for rental will therefore compete for land with house builders that sell to the owner occupied market
- Because property can switch freely between the owner occupied and private renting markets, the opportunity cost of an investment in housing is the price it could achieve on sale to an owner occupier, not another investor

37. We received many representations from private sector respondents that the Government should do more to accelerate the **release of surplus land**, as the limited availability of suitable sites is seen as a major constraint to developing the volume of stock required to support an expansion of institutional interest in the sector. The government's commitment to bring forward central government land with capacity for 100,000 homes by March 2015 shows that it recognises, in principle, the importance of surplus public sector land in supplying the residential development market.

38. There is a growing and welcome body of experience of public bodies successfully pursuing a more entrepreneurial approach in implementing the Government's commitment. In addition to outright sales for immediate cash settlement, respondents commented favourably on Build Now Pay Later transactions, and on Joint Ventures and similar schemes where the continuing economic interest in the land is effectively shared between the public body and the developer.

39. We did, however, receive reports from existing participants in the market that the **requirement to obtain best consideration operates as a brake** upon the release of land for rental development, as public bodies are (with some exceptions) expected to seek consent if they do not receive the unrestricted market value for a site, and may therefore prefer to sell land for development as owner occupied units. We have considered whether we should recommend a loosening of the Best Consideration rules to adopt the principles of Managing Public Money (which look at value for money in terms of economic value, not just financial return) in order to permit a broader range of factors than just the cash consideration achieved to be taken into account, but recognising the significance of such a change, at this stage we do not suggest it. Instead, we think the Government should be open to a controlled experiment to establish what might be achieved if a broader definition of value for money is adopted.
40. All in all, we have the sense that the Government's drive to step up the release of surplus public land is starting to show results, although the Best Consideration rules direct much of the flow towards the owner occupied market and, therefore, create an unintended policy obstacle to the expansion of the private rented market. For all of this, however, from the evidence received, it's clear that there is still a significant body of opinion among stakeholders that Government could do more. It's difficult to elicit specific suggestions from stakeholders, perhaps because the extent of the good work being done at the administrative level to identify, record and prepare surplus land for realisation is not readily perceptible. In the light of this, we suggest that Government should be alert to any opportunity to make a clear and tangible demonstration of its commitment to use public land to foster the expansion of the private rented sector.
41. **There is a shortage of expertise and experience on all sides.** The relative novelty of this kind of development and the lack of operational comparisons makes it a challenging sector for local authority planners or public sector landowners. Even where they can see the benefits of developing homes for private rent, they may not be familiar with how to make it happen. Schemes need to be tailored to local markets and bring together a range of quite disparate interests. Even for familiar models, this can be challenging. But, for build to let, there are no tried and tested models to fall back on to help them ensure that they deliver the best deal for their communities.
42. At the same time, investors are concerned about a perceived shallowness of the pool of management expertise in residential investment, which has implications both for the delivery of economies of scale and for reputational risk. Some institutions still had concerns about the reputation of the sector – historically quite a significant barrier - but the predominant view was that this was becoming less of a

factor and could be addressed satisfactorily by strong management arrangements.

43. Above all, this uncertainty and lack of experience causes potentially viable schemes to stumble and stall. One investor told us that they eventually walked away from an investment because it was taking too long to put together: it simply “went cold”.

# Conclusions and recommendations

44. This review set out to consider whether there was significant potential for institutional investment in privately rented homes, whether the changes Government had already made were sufficient to kick-start that investment, and what else might need to be done.
45. It is clear that, on the demand side, there is real potential for investment in large scale developments of purpose built rented housing to grow and to be viable. This type of development can bring in new money, give a boost to housing supply, and provide more choice for tenants, particularly those who may be renting long term. And there is research<sup>15</sup> which suggests that the lack of high quality private rented accommodation can put a brake on the wider growth of economic activity.
46. It is also widely accepted that the conditions now are more favourable to this kind of development than they have been in recent years. A combination of recent tax changes and wider market conditions have cleared the way for this market to grow. There are some models already emerging which are establishing the concept and slowly developing the expertise which will help others to overcome the barriers in the longer term.
47. But the challenge right now is to secure a step change on a faster timescale – a significant boost to housebuilding now, to meet existing and growing demand for rented homes. Delivering that step change will require further action from Government – to address the structural gap that currently separates housebuilders, investors and local authorities, and to give confidence to investors.
48. The recommendations below aim to deliver that step change. The premise underlying the recommendations is that the rented housing sector will continue to benefit from the stable legislative and regulatory framework it has enjoyed in recent times. Investors have made it clear that their current interest in the sector would easily be undermined by proposals for rent controls or enhanced restrictions on gaining vacant possession. We **urge the Government to reaffirm its support** for the existing framework in its response to this report.
49. **Recommendation One.** Local authorities should use existing flexibilities in the planning system to plan for and enable developments of privately rented homes, where they can meet local needs. The National Planning Policy Framework has enabled this by embedding a flexible and permissive approach, but both housebuilders and local authorities lack experience in developing proposals for rent.

---

<sup>15</sup> Investing in private renting, Professor Michael Ball, November 2011

Government must show them the way by providing practical advice and support to local authorities to enable them to, for example:

- Specifically recognise the role of the private rented sector when assessing housing demand and planning for housing. Building and designing specifically for the rental market in the right locations should be recognised for the wider benefits it brings to local communities and economies, and Government should include in guidance to authorities a strong steer to specify private rental needs as part of their strategic housing market assessments;
- Use planning tools such as conditions associated with planning permissions or covenants on the land to ensure that new homes remain in the rental sector for a fixed period of years. Most of our respondents agreed that any restrictions should be for at least 10 years. Others felt that 15-20 years would be more desirable, and some major institutional investors argued for very long periods of up to 30 years. By analogy with the commercial market, a term of 10-21 years seems a sensible benchmark for authorities to aim at. Whatever the period selected, this should mean that land values used in calculating developers' and investors' business plans would reflect the land values based on rental tenure rather than theoretical valuations based on sale. It would also mean that the local authorities themselves could be sure that the resulting housing would continue to meet their local communities' needs;
- Feed the revised land values and business plans into negotiations around s106 and Community Infrastructure Levy. Land values based on rental tenure, as outlined above, will often not be strong enough to support the imposition of extensive affordable housing obligations. So, whilst desirability of affordable housing should not be ruled out, it should be weighed against the benefits already built into market rent developments, in the context of an accurate assessment of the economics of building homes to rent. In many cases, it will be appropriate for authorities to waive affordable housing requirements in relation to schemes for private rental, or to the private rental component of larger schemes also including an owner occupier component. And local authorities should review stalled sites to engage the potential of private rented units to accelerate delivery.

**50. Recommendation Two.** The Government has committed to release public sector land with capacity for 100,000 homes by 2015. Each department has a target for land release and has to regularly report back on progress through a designated Minister to a Cabinet Committee. This impetus and level of accountability should be maintained and, to enhance transparency, the Government should, in addition, publish separate information regarding the use of released public land for private rented projects.

51. To demonstrate its commitment to making a success of private rented schemes on public land, we recommend that the Government identifies, in partnership with local authorities and the Greater London Authority, a number of sites in locations where there is a good demand for rental housing and makes them available to developers on the basis of a pre-determined volume of build-to-let. Recognising the strength of rental demand in London, some projects should be located in London boroughs and be conducted in conjunction with the Greater London Authority and the relevant borough but, as it is important also to demonstrate the viability of the model in markets outside London, others should be undertaken in partnership with local authorities in the Regions. In order to set the model, value for money in these projects should be considered in the round in order to test whether best value, and not just the highest cash consideration, can be achieved. Depending on the outcome, this approach could then be applied more widely.

52. **Recommendation Three.** We have heard how the lack of an established body of best practice, norms and market benchmarks is a significant barrier. We need to speed up the emergence of schemes which better reflect both the product and the scale that investors are looking for. And we need to demonstrate how these schemes can deliver the yields and benefits we have identified. In order to do this, Government should provide carefully targeted incentives to stimulate the rapid development of new business models, from a range of promoters – public sector landowners, registered providers, or private sector housebuilders.

53. Government should consult further on the detailed form and scale of incentives but the most effective interventions are likely to be:

- Equity or debt funding to support schemes that can be sold into the institutional market once completed and which would act as demonstrations of possible viability, particularly around yields. Investment in these schemes might take the form either of equity or support with construction financing, and would be predicated on the recycling of the public capital once the development had been completed. This could build on the existing “Get Britain Building” model, but designed specifically for rental schemes. This support might be made available first to the pilot schemes supported by Government, and then rolled out to other projects under a more general programme of incentives.
- Recognising that institutional interest is likely to be mainly focussed on the take-out of completed and stabilised developments, government should also consider seeding institutional funds in order to leverage in other private capital. This funding should be on the same terms as private investment, without any element of subsidy, and should be seen as a demonstration, through the power of example, of the Government’s determination to trigger a

significant expansion of institutional interest in the sector. In order to align its interests with those of other investors, any such funding should only represent a minority interest in the fund and should have no special rights or protections.

- A number of respondents urged on us Government guarantees of different descriptions (rent, capital, refinancing and voids) as a way of stimulating the market. We do not advocate guarantees of any of these descriptions as they tend to distort the market and allow schemes that would be unviable without the presence of a guarantee to proceed. But government might wish to consider how it can share investment risk in the short term in the same way as universities did in the early days of the student housing market.

**54. Recommendation Four.** In order to provide some of the expertise and support to overcome barriers around the unfamiliarity of these schemes, government should establish a dedicated Task Force focussed on private renting to act as an enabler. The Task Force would work closely with the Homes and Communities Agency, and would be composed of a range of officials and private sector specialists (including developers, lenders, investors, valuers and lawyers), under the leadership of a private sector Chief Executive. Its role could be

- to act as the focal point for private rented schemes across the public sector and to co-ordinate with interested parties in the private sector, including financial institutions in the UK and overseas, landowners, banks with distressed land, developers and others;
- to promote a standardisation of the process – including a statement of expected standards - and of forms of contract;
- to identify and scope the pilot projects we recommend that the Government undertakes, and to support the Department in arranging and negotiating specific transactions benefitting from any agreed financial incentives made available by Government;
- to work with the Homes and Communities Agency to ensure that the private sector is fully aware of all opportunities regarding surplus public land held for release; and
- to provide transactional support (e.g. as regards viability studies, scoping and contract negotiation) to the public sector, especially for smaller authorities that may not have the experience or resources to handle transactions with private sector developers off their own bat, and to encourage authorities to work together.

**55. Recommendation Five.** The emergence of a stronger, high-quality private rented sector will enhance the lives of many graduates, young professionals and couples with small children, not just as a stepping stone to eventual occupation, but also because it caters for their need for flexibility in accommodation as their careers start to take shape. But we need to confer a new sense of identity on the product. We considered whether it might be possible to distinguish high-quality new-build rented homes from existing residential stock in order to give both tenants and wider communities assurance of a consistently high standard of proposition. In the end, we concluded that a formal or mandatory “kitemark” might be overly-bureaucratic, and cut across developers’ own brands. Nonetheless, we consider that the market would benefit from a clearer understanding of what tenants should have the right to expect as regards:

- the quality of the accommodation and the standards of construction,
- the level of energy efficiency and sustainability of the building,
- the building owner’s promises as regards the maintenance and refurbishment of the premises, and
- the professionalism of the management service.

We therefore recommend that the Housing Task Force work with the other industry bodies to develop voluntary standards that could be adopted across the build to let sector, specifically by those schemes supported by government.

## **INDEPENDENT REVIEW OF THE POTENTIAL FOR INSTITUTIONAL INVESTMENT IN THE PRIVATE RENTED SECTOR**

### **TERMS OF REFERENCE**

#### **Background**

The Private Rented Sector has grown rapidly in recent years, and now houses 3.4 million households. During that period of rapid growth, rents remained stable in relation to earnings, and the quality of housing in the sector has improved. However in the last two years, rents have started to rise faster than earnings in some areas. At the same time, the dominance of small landlords has increased to the point where just 1% of private landlords own more than 10 properties.

In this context, this government has been exploring the scope for the private rented sector to attract investment and, in particular, investment in new housing:

- In September 2010, we published the “Government response to the consultation on investment in the private rented sector”, which included a full consideration of potential tax measures;
- This led to measures in the 2011 Budget Statement to encourage increased investment;
- In November 2010 we published “Promoting investment in Private Rented Housing Supply: International Policy Comparisons” ; and
- Most recently, there has been progress in developing models to increase the potential for institutional investment in the private rented sector and a handful of schemes are now underway.

#### **Purpose and aims**

This review will build on this work and will avoid re-visiting issues which have already been considered in detail – in particular through HMT’s 2009 consultation. Instead it will focus on the potential for investment in the private rented sector in current market conditions. In particular:

- What evidence is there about the ability of the private rented sector to respond to future demand, and the impact of this on labour markets and growth? Is there a market failure?
- How does this compare to other countries?
- What interest is there among institutional investors for long term investment in housing?

- What are the characteristics of housing investment which might attract (or deter) institutional investors?
- What has been the experience of those who are developing new models for investment in the sector?
- What can we learn from large-scale investment in student housing?
- What drives current landlords' business plans – costs, income, risks, long term strategies?
- How has the sector responded to the changing profile, expectations and aspirations of those who rent?

The review will make recommendations to the Housing Minister. Any representations on tax issues would need to be made to HM Treasury separately through the normal budget process.

## Annex 2

# **INDEPENDENT REVIEW OF THE POTENTIAL FOR INSTITUTIONAL INVESTMENT IN THE PRIVATE RENTED SECTOR**

## 1-2-1 Meeting Attendees

Andrew Appleyard and Neil Gardiner of Aviva Investors  
Anna Kavanagh of AXA  
Bob Williams of Barratt Group London  
Tom Olsen of Berkeley Group  
Tony Pidgley of Berkeley Group Holdings  
Clive Skidmore, Service Integration Head, Birmingham City Council  
Nicolas Guerin and Stephane Slama-Royer from Bouygues  
James Wardlaw of Campbell-Lutyens  
Richard Powell of Capital and Counties Properties  
Jennet Siebrits of CBRE  
Stephen Yorke of D&G Investment Management  
Wally Kumar of Development Securities  
Trevor Moross of Dorrington  
Paul Walker of Enfield Council  
Charles Fairhurst of Fairbridge Residential  
Elliot Lipton of FirstBase  
Nick Jopling of Grainger  
John German of Grosvenor  
Richard Blakeway of the GLA  
Helen George, Housing Strategy and Policy, Hertsmere Borough Council  
Robert Napier, Richard Hill and Gareth Blacker of HCA  
Mark Henderson of Home Group  
Richard Donnell of Hometrack  
Garry Taylor of Hull City Council  
Linda McAleer of Hymans Robertson  
Mark Weedon of IPD Research  
Robin Goodchild of LaSalle  
Pete Gladwell & Bill Hughes of Legal and General  
Tony Mousdale of Liverpool City Council  
Tony Oakley of Lloyds Banking Group  
Councillor Ed Turner and Nick Gracie-Langrick of the Local Government Association  
Dominic Curran & Nigel Minto of London Councils  
John Dickie, Jonathan Seager and Faraz Baber of London First  
David Montague of London & Quadrant  
Simon Berrill of Macquarie Capital  
Paul Beardmere of Manchester City Council  
David Toplas of Mill Group  
Chris Millington  
Rosamund Bromfield-Smith and Brian Johnson of Moat Homes

Stuart Ropke of the National Housing Federation  
Councillor Andrew Baikie and John East of Newham Borough Council  
Oliver Hemsley and Heraclis Economides of Numis Securities Ltd  
Stephen Howlett and Claire Bennie of Peabody  
Chris Jones of Places for People  
Michael Wood of Prudential  
Richard Parker of PWC  
Stuart Corbyn of QDD East Village  
Richard Smart of The Royal Bank of Scotland  
James Coghill, Andrew Brentall, Charlie Weatherill and Jim Ward of Savills  
Edward Trevillion of Scottish Widows  
Alan Gillman of Skanska  
Judith Salomon of St George  
Geeta Nanda of Thames Valley Housing Association  
Jackie Sadek & Paul Evans of UK Regeneration

## Call for Evidence Respondents

HTA  
DTZ  
Hertsmere Borough Council  
Hastoe Group  
Knight Frank LLP  
London First  
SMA Property  
Blackswan Land Ltd  
Richard Carter  
LSE Christine Whitehead  
Yannis Archbold  
Hempsons  
Liverpool City Council  
Gentoo Group Ltd  
Evenbrook Capital Partners Limited  
The Paragon Group of Companies Plc  
D&G Asset Management LLP  
Places for People  
RICS  
CCURV (John Laing & Croydon) [Confidential]  
Thames Valley Housing Group  
Mill Group  
HCA  
Westminster City Council  
Stanford Mallinson  
NHF  
Property118.com  
Residential Landlords' Association  
Genesis Housing Association  
Archstone  
Grainger Plc  
Hull City Council

Grosvenor  
HBF  
CML  
London Councils  
Jones Lang LaSalle  
Shelter  
Christine Haigh  
National Landlords' Association  
Hamptons  
AREF, BPF and IPF  
Allsop LLP  
CBRE  
Professors Crook and Kemp  
Kazuri  
Absalon Project  
ARLA  
Igloo Regeneration  
Birmingham City Council  
BPF  
Berkeley Group  
Unite  
LGA  
Orbit  
CRISIS  
IPD  
Gainsgrove Ltd  
Keepmoat Group  
John Finlay  
Martin Partington