Rapid evidence assessment of the research literature on the buy-to-let housing market sector

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Building Awareness For The Future

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ECOTEC is an international provider of research, consulting and management services. Our aim is to deliver real benefit to society through the work we do. For more than twenty years we have worked with clients in the public, private and not for profit sectors. Our housing research and consultancy team specialises on housing research and intelligence, housing policy analysis, supporting regional and sub-regional planning and housing market renewal.

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Executive summary

This report reviews evidence on the buy-to-let (BTL) market on behalf of the National Housing and Planning Advice Unit. It focuses on the supply side of the private rented market, particularly looking at investor characteristics and their motives for investing. It also considers the interplay between BTL, house prices and first-time buyers.

We have used a rapid evidence assessment to review literature on the BTL market. This is a methodology for assessing evidence, particularly published literature, to guide public policy research and evaluation. It aims to find out what is already known in a quick and efficient but critical way.

Using a broad definition of BTL – buying property with the intention of letting out – we have generated a wider pool of evidence. We have found most evidence on the particular characteristics of investors or the housing markets they invest in and the future prospects for the sector. Evidence has been most lacking around the supply and quality of BTL housing stock, vacancy rates and international evidence.

The private rented sector is today bigger in size and proportion of the housing market than in the late-1980s, currently housing some 2.5 million households and representing 12% of all stock. BTL mortgages make up just over a quarter of the whole PRS stock, although some of this investment represents remortgages rather than additional purchases.

Characteristics of investors and investment motives

The overriding motive for private landlords is to receive a financial return, with returns in residential property outperforming other forms of investment in recent times. Yet landlords have different motives for investing. The biggest group of BTL investors are small-scale and amateur, investing for retirement. These are most likely to expect to continue letting property over the medium- to long-term.

Speculative investors form a second group, though much smaller in size. They are seeking short-term gain through capital growth and are concentrated in new-build apartments. There is also overlap between this group and the ‘buy-to-leave’ phenomenon, with properties bought as an investment but with no intention of letting out. A concern for both groups is that there appears to be a saturation of the PRS in some markets which could lead to a fall in prices. Another worry is that such investment has encouraged developers to build small apartments, although there may not be sufficient household demand for such units.

The third key group of landlord is those who own large portfolios. These investors are more focussed on generating a positive cash flow from rental income and less preoccupied with short-term capital growth. Understandably, this group of investors is also more professional and knowledgeable about housing tax and finance.

Housing quality and voids

The private rented sector has consistently held the highest level of unfitness among all tenures, although fitness appears to have increased dramatically over the decade. Improvement to property condition appears to happen more with new stock entering the market than by the active modification by landlords.

Some BTL investors are happy to hold on to poor-quality stock and obtain high rental yield, though have little interest in long-term capital growth. These landlords have been called 'rent maximisers', though may face higher voids. Another group of landlords often buys good-quality stock and invest to maintain this high standard or buys poor quality stock but improves it. These investors will receive better capital growth but reduced net rental yield, because of higher management and maintenance costs.

Evidence on vacancy periods and void rates is patchy but generally consistent. Some 6%–7% of landlords' properties appear to be vacant at any one time, and the duration of voids is about one month per year. These figures are probably currently for BTL investors, but there would be a public policy concern if demand dropped or the BTL market became saturated with supply.

Investors and the wider housing market

The lending industry and some academics view BTL mortgages as a positive contribution to how investors operate. Some state that gearing (that is the relationship between invested equity and debt) is low in the PRS, and see much potential for investors to improve their returns if they borrower further. For the lending industry, BTL borrowers are currently proving to be a safer bet than others, as BTL borrowers have lower levels of arrears.

Few of the studies provide empirical evidence on a direct relationship between BTL investment and house prices, and none has shown that BTL alone has increased prices. Instead, a number of studies conclude that the housing market is more complex, with no single element precipitating rapid house growth. There is stronger evidence that private landlords are attracted to low value properties, therefore making an association between BTL and property prices.

There is also concern that investors have priced out first-time buyers. Yet the evidence is ambiguous. A number of studies state that rather than pricing out first-time buyers, BTL is providing a demand-led alternative at a time when attitudes to homeownership have changed. Other studies point to a different interplay between BTL investment and first-time buyers. Alternative reasons for the rise in property prices include weak housing supply, new demand as a result of in-migration, low rates of property transactions, rising incomes at a time of low interest rates and the deregulation of mortgage markets. The strongest case for BTL investors pricing out potential owner occupiers is found in the competition for small new-build apartments and city centre or waterside developments. However, more rigorous research is required.

Future prospects

Most studies found that the majority of landlords regarded their investments as medium-to-long-term and that landlords plan to maintain the size of their portfolio. But more landlords, particularly BTL borrowers, intend to buy properties than sell them, showing confidence in the market.

One in-depth survey of BTL borrowers found that stable or low interest rates, stable or rising house prices and very good rental yields were seen as primary reasons for increasing one's investment portfolio; rising interest rates and insufficient rental income to cover mortgage payments were identified as primary reasons for decreasing holdings. This is used to show that landlords' behaviour is cyclical rather than counter-cyclical.

A number of studies conclude that the risks are greatest for new investors. These are most likely to be inexperienced in the letting process, have higher financial risks and experience slower capital growth. If these landlords have to sell up, this would be unsettling if they are concentrated in particular property 'hot-spots' and would be painful for these investors.

There is considerable uncertainty over the likely future demand for private renting. But on balance, it appears that demand will increase because of affordability problems in owner occupation and quite large changes to the population structure from new migrants. So long as supply has not become saturated, BTL will have a place; but where an over-supply has already occurred, a short-term contraction may take place.

Conclusions

Our key conclusions are:

- The **PRS is today bigger** in both number and as a share of all households than its lowest point in the late-1980s, and is growing rapidly.
- But there are **different motivations for buying and letting property**, mostly driven by a desire for a financial return. The biggest group of investors are small-scale and amateur landlords, seeking a return for their retirement. A small proportion of BTL investors have made speculative investments for short-term capital growth. A third group of BTL investors is professional landlords living on rental income.
- **Landlord behaviour appears to be cyclical** rather than counter-cyclical. However, landlords' predicted behaviour and their actual behaviour might not be the same, and that new entrants may not behave as their predecessors did.
- **House prices are driven by a complex interplay of factors.** BTL investment will be one of these but not the sole or even necessarily the major factor. The evidence shows the strongest direct relationship between BTL and new-build apartments. The low price of old terraced stock in housing market renewal areas has been an incentive for BTL investment.
- The most rapidly changing part of the English housing market is the part **we currently know least about**.

We suggest that future research on BTL should therefore look at:

- the extent to which BTL investment has 'priced out' first-time buyers, and how this interacts with the local housing market;
- the motivation to invest in property maintenance by newer landlords and their use of managing agents;
- demand for private renting among new groups, particularly A8 migrants;
- geographical gaps, particularly in cities with large student populations and in coastal areas, where private renting is higher;
- local authority-level systems to monitor developments and trends in the PRS, to ensure that they understand the changing market – these should also use a common methodology to compare across regions; and
- updating old evidence.

1. Introduction

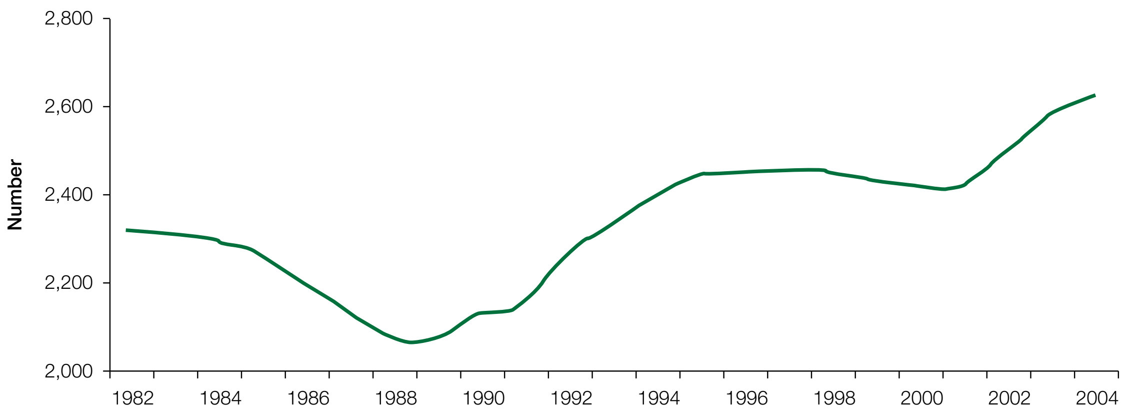
This report reviews evidence on the buy-to-let (BTL) market on behalf of the National Housing and Planning Advice Unit. It has been carried out by ECOTEC with support from Professor Ian Cole at the Centre for Regional Economic and Social Research at Sheffield Hallam University. This section focuses on the context of BTL, the methodology we have used, and the strength of evidence reviewed.

Throughout this project we have used a broad definition of BTL: buying property with the intention of letting it out, not just with a BTL mortgage. This takes into account properties that have been bought outright and those bought using other means (eg mortgages on other properties, business loans). A key concern, though, is whether new investment (often with BTL mortgages) is affecting the established market, which is considered in this report. Where we consider investment with BTL mortgages (the narrow definition), we talk about 'BTL borrowers' or 'BTL mortgages'.

1.1 A growing sector

The size of the private rented sector (PRS) at large was in steady decline throughout most of the twentieth century. Its lowest point in England was in the late-1980s, when the sector dropped to just over 2 million properties, representing just 10% of all stock (Thomas, 2006b). But there has been clear growth since then. Today the sector is bigger in size and proportion of the housing market (Figure 1.1), housing some 2.5 million households and representing 12% of all stock (CLG, 2007). Although the tenure is still dwarfed by owner occupation (accounting for around 70% of stock), the absolute and relative increase in properties is significant.

Figure 1.1 Number of dwelling in the private rental sector (thousands)



Source: Thomas (2006b) using ODPM figures

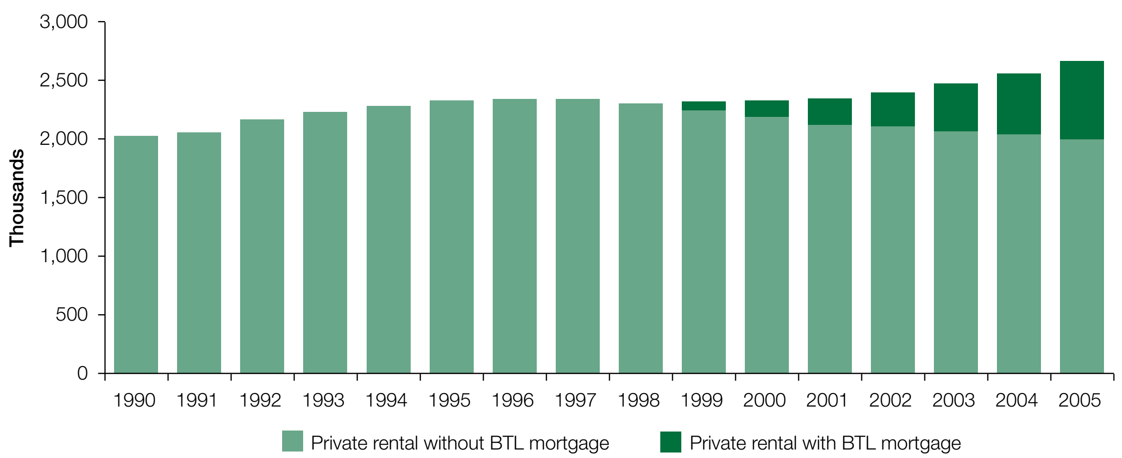
The development of the sector has not taken place evenly across the country as some local markets have experienced higher levels of PRS growth than others. For example, ECOTEC (2007) estimated the PRS in the NewHeartlands housing market renewal pathfinder area to have grown from 19% to 26% of stock in the five years to 2006. This is a very steep rise and demonstrates the very quick change in property ownership, coupled with new supply, in some neighbourhoods. Other local level studies have underlined this. For example, Gibb and Nygaard (2005) estimated that the entire PRS had grown in Glasgow from under 7.7% to 9%–10% in the three years to 2004. Unsworth (2007) shows the scale of this potential growth, with some 19,000 units in the planning pipeline in Leeds. Even if all these do not come to fruition, it will take some time to stem the flow.

1.1.1 BTL mortgage market is also increasing

BTL mortgages were first introduced by the Association of Residential Letting Agents (ARLA) in 1996, as a means of allowing investors to borrow specifically to invest in residential property. The home loans were first offered by a select panel of providers but today have grown to form an important segment of the mortgage lending market.

Figure 1.2 shows recent evidence from the Council of Mortgage Lenders (CML), with BTL mortgages making up just over a quarter of the whole PRS stock. The industry is quick to boast the huge numbers involved. For example, Thomas (2006b) stresses that the BTL (mortgage) part of the wider PRS has grown from 1% to 20% in just six years. He goes on to say: "By mid-2006, there were over 750,000 buy-to-let loans outstanding with a total value of £84 billion." (Thomas, 2006b, p1; echoed in Ball, 2004, 2006).

Figure 1.2 Private sector rental properties with and without a buy-to-let mortgage



Source: CML (2007)

The growing importance of BTL mortgages is clear. But properties bought with such mortgages are not all new stock to the sector. Lenders say that a large share of BTL loans are remortgages of existing investment properties. Data for 2004 states that 37% of BTL mortgages in that year were remortgages (Scanlon and Whitehead, 2005). As the take-up of BTL mortgages is often – but wrongly – assumed to indicate new PRS stock, this creates a false impression. The trend is therefore not as straightforward as often assumed.

1.2 Research questions

The BTL market has clearly grown in importance within the PRS at large. It has prompted much media attention, especially as it is believed by some to have had an adverse effect on the wider housing market, and has provoked intense political and policy interests as a result. To investigate these concerns surrounding BTL the NHPAU set nine research questions to be answered by this project:

1. To what extent (if any) has BTL increased house prices?
2. What specific factors attract buy-to-let investment into a particular local housing market and to certain types of property, and what are the characteristics of investors?
3. Has property speculation in BTL priced out prospective first-time buyers?
4. What is the impact of BTL on private rental provision?
5. Has there been any improvement in the supply and quality of the housing stock as a result of BTL?
6. What are the vacancy rates of BTL properties?
7. Is there any international evidence that can be drawn upon?
8. What are the future prospects for the BTL sector?
9. Are there any gaps in the evidence base in relation to the above questions?

The focus of this project has been on the supply side of the housing market, with little evidence specifically reviewed on demand for private renting. Although the sector would not function without both supply and demand, the latter has not been the impetus for this project and so is not covered in any depth in this report. Because the sector changes so rapidly, some phenomena are too recent to be captured in already published research evidence. An example is investment clubs, which are used to pool capital to buy properties to let. Such aspects of the market are understandably beyond the scope of a rapid evidence assessment, though no doubt are having an increasing influence on the market.

1.3 Methodology: the rapid evidence assessment

1.3.1 Rapid evidence assessment explained

We have used a rapid evidence assessment to review literature on the BTL market. This is a methodology for assessing evidence, particularly published literature, to guide public policy research and evaluation. It aims to find out what is already known in a quick and efficient but critical way. The approach is more critical than a literature review and closer to a systematic review.

The government's Magenta Book (Davies, 2003) explains the rapid evidence assessment. In systematic reviews, all evidence on a subject (eg effects of pharmaceutical drugs) is brought together to find consistencies and explain variation between studies. Unlike other types of research synthesis, systematic reviews are more methodical and rigorous in the way they search existing evidence, with explicit and transparent criteria for appraising evidence and explicit ways of comparing different studies. This way of synthesising evidence is clearly more critical than a standard literature review.

A rapid evidence assessment is one step back from a full systematic review, as it seeks to critically appraise the evidence but quickly. It therefore relies on evidence that is readily available, identified by keyword searches of electronic databases and websites; hand searches of journals and reviewing 'grey' literature (unpublished studies or work in progress) are not necessary. The main purpose is to establish what is already known to determine if any further, detailed research is needed. However, the critical manner of appraising evidence is still evident and a transparent approach remains important.

1.3.2 Our approach

Our approach to the rapid evidence assessment has therefore stressed that the search criteria and process are transparent (Annex 1 contains further details of our search strategy), that evidence has been appraised in a clear and open way (Annex 2 contains our review template) and that gaps in the evidence have been identified.

For the assessment we have gathered literature from a variety of sources, including: central, regional and local government; academic sources; industry representatives; and private consultancies. We have gone beyond the normal scope of a rapid evidence assessment by contacting all nine regional assemblies (and the Greater London Assembly). We are grateful for their help in providing the most recently published literature on BTL, which has offered some wider stakeholder consultation and allowed us to use the most up-to-date evidence.

We have appraised all literature using a standard template, probing the methodologies used in the studies, their limitations and bias. Putting all these factors together, we graded each item of literature as low, medium or high quality for the particular research question. This review has been summarised in each mini report on the six research questions that we have answered separately. The limitations of literature mainly referred to the transparency of the methodology, the use of primary evidence and sample sizes (though a full list is included in Annex 2). Rather than exclude literature, we have included anything that matched the primary research questions or secondary issues (outlined in Annex 1). Where a study had only limited relevance, we have included it in the review but usually given it a low or medium grade.

1.4 Quantity and strength of evidence

For a rapid evidence assessment to go beyond a traditional literature review it must assess the quality and strength of evidence. Overall there has been only limited evidence looking at the BTL market in its narrow sense, that of purchasing property with a BTL mortgage. But this project has used a broader definition: buying property with the intention of letting out. This wider definition has generated a wider pool of evidence, with studies looking at the PRS more broadly. Some of the evidence we have reviewed has been generic (eg Ball, 2004, 2006; ODPM, 2003, 2006), while other studies have had a much narrower remit (eg Crook, 2002) or somewhat limited relevance to this project (eg Holmans, 2005).

1.4.1 Some research topics covered well

In our review, we have found most evidence on the particular characteristics of investors or the housing markets they invest in (research question 2) and the future prospects for the sector (Q8). This is mainly due to three reasons. First, a large share of the evidence has been commissioned by public or publicly accountable agencies trying to plan and operate in local housing markets. Second, much of the work has been empirical to understand investors in the market, either personal characteristics (eg age, location) or property characteristics (eg type of dwelling, portfolio size). Third, the interest in the future prospects of the sector is driven by a concern for the wider housing market and an interest in how public policy can anticipate the direction of development in order to respond effectively to it.

We have found less evidence looking at the impact of BTL on house prices (Q1), first-time buyers (Q3) and private rental provision (Q4). The wider research material on house prices and first-time buyers has been more interested in the owner occupier market (eg Holmans, 2005; Wilcox, 2005, 2006). We have found a lack of academic investigation into the relationship between the owner-occupier market and the investment market. Equally, evidence on private rental provision has been included in some of the studies we have reviewed but often in conjunction with other research aims.

Evidence has been most lacking around the supply and quality of BTL housing stock (Q5), vacancy rates (Q6) and international evidence (Q7). Although the quality of PRS stock has consistently been identified as poorer than in other tenures, the means of improving this stock are less well understood. There has been much greater policy momentum to bring social rented housing up to the decency standard, so there has been more emphasis and research on this issue. Vacancy rates, meanwhile, are sometimes alluded to in broader research findings but they do not feature as the subject of stand-alone studies. Lastly, international evidence on housing issues tends to be provided by academic literature and although there is some evidence on BTL available, this is very limited (eg Montezuma, 2006; Mandič, 2000). The inherent difficulties of developing a comparative understanding of housing markets, given their unique characteristics and histories have limited the amount of such evidence. It is therefore highly problematic to offer superficial comparisons between the English housing market and markets in other countries.

1.4.2 Varied affiliation to the subject

When looking at the evidence reviewed by affiliation to the subject, there are five distinct groups. They are described here in order of amount of evidence produced:

- **Academic literature:** A large share of the evidence has be commissioned by the Joseph Rowntree Foundation or published in academic journals and books. Such studies have almost all had strong and transparent methodologies and generally looked at the PRS nationally. Academics have also worked on research commissioned by other organisations outlined below.
- **Local, sub-regional and regional level agencies:** The second most common type of evidence has been commissioned by local authorities and sub-regional or regional bodies. These have been produced by private consultancies as well as academics. They have been particularly common in towns and cities working on housing market renewal, in South East England (including London) and where there are large student populations. Much evidence in this group has also been of high quality, though some studies have relied on relatively small samples and therefore contained high margins of error.
- **The lending and letting industries:** There have been a few studies by and on behalf of the lending and letting industries, particularly for the CML and ARLA. These have often drawn on industry data that would otherwise not be published and are often up-to-date, so a valuable contribution to the literature. They are weak, however, by reporting much opinion; they are closer to promotional material than solid and transparent research evidence.
- **Other national level organisations:** Some research has been commissioned by other organisations with a particular interest in BTL. The best example is Kemp (2004), commissioned by the Chartered Institute of Housing, which provides one of the most in-depth understandings of the PRS, though no primary evidence is included. Another example is Ball (2004), commissioned by the Social Market Foundation to stimulate discussion on the performance of markets and the social framework. A third is Birch (2007), an article written for Roof, the magazine of housing rights charity Shelter. The article provides new evidence on housing affordability but is selective in presenting data.
- **Central government:** Just a few of the studies reviewed have been commissioned directly by central government. The two national surveys of private landlords (ODPM, 2003, 2006) are strong empirical datasets and provide a good overview of the broad BTL market. Surprisingly few other studies (before this project by the NHPAU) have been commissioned by central government that look in particular at BTL, although the evaluation of the housing benefit reforms (eg DWP, 2005, 2006) has provided some useful comparative evidence along the way.

1.4.3 Mostly national or local authority geographic scopes

Those commissioning work have generally determined the geographic scope of studies. This has resulted in a fair amount of evidence at national level but a patchwork of studies at a lower spatial level.

The two surveys of private landlords carried out alongside the English House Condition Surveys (ODPM, 2003, 2006) are good examples of national level studies providing much empirical data on a range of investor and property issues. Their shared limitation is that even such large samples are too small to break down to regional or local authority level. Both reports acknowledge this drawback, though, and do not attempt to break down the samples spatially.

Most of the studies carried out by academics are also at a national level. This is often because they have been commissioned by the Joseph Rowntree Foundation or bodies with a national interest (eg ARLA, CML, Social Market Foundation). The benefit of such studies is their scale and broad remit in terms of understanding the working of the housing market at large. Their weakness is a lack of detailed understanding of particular housing markets or sub-markets.

This drawback is allayed by studies that have considered the BTL and the PRS at a regional or sub-regional level. These include ECOTEC (2007), Green et al (2007), Hickman et al (2007), London Development Research Ltd (2006), Pendle Borough Council (2007) and Savills Research (2007). The advantage of such studies is being able to concentrate on links and interactions between the BTL and the rest of the PRS, and between different tenures, on more localised phenomena and providing much larger samples at a local level. For example, Green et al include a survey of 576 landlords, almost the same sample size as one of the national surveys (ODPM, 2003). These studies are particularly useful for shaping regional policy making.

We have also found some evidence on BTL collected at a local authority level. In particular these are: CSR Partnership (2004), CRESR (2007), ECOTEC and SURF (2006), Gibb and Nygaard (2005), Knight Frank Residential Research (2007) and Unsworth (2007). These have the added benefit of understanding change at an even smaller level, sometimes down to parts of towns or cities (eg west Glasgow) and even down to neighbourhood level (eg Nottingham’s Lace Market area). However, some of these studies are weakened by relying on small samples (eg 24 landlords in Glasgow and 14 agents and developers in Nottingham).

At an even more localised level, when looking specifically at neighbourhoods, we have found much less evidence. Although there will undoubtedly be less research at this level, some studies will exist that have been beyond the scope of our search strategy. Yet property investors are often attracted to particular streets or neighbourhoods, not just towns or cities, so such localised research is important. The Leeds Beeston Hill case study in Hickman et al (2007) is an exception in the literature, although it was purposely included in their research as a distinct case study and not just studied because of a local public policy concern.

1.4.4 Methodologies focused on housing market analysis

Many types of methodologies have been used in the studies we have reviewed. Some research has relied exclusively on empirical data collected from surveys (eg ODPM, 2003, 2006). Most projects, though, have combined methods for collecting data, often using qualitative and quantitative approaches (eg ECOTEC, 2007; Green et al, 2007; Hickman et al, 2007). Most techniques have appeared adequate for collection and analysis, although some studies have used seemingly inappropriate methods (eg collecting mainly statistical evidence using interviews rather than paper questionnaires in Gibb and Nygaard, 2005) or relied on weak statistical associations (eg Crook, 2002, although these were acknowledged).

We have also included a few studies that have exclusively used secondary evidence (Ball, 2004; Kemp, 2004). Although these would not normally be included in rapid evidence assessments, we have done so because they have been large-scale and offered depth to the topics covered. We have, however, been cautious not to double-count such evidence when reviewing the primary sources, too.

By research discipline, most evidence comes from the applied and eclectic 'housing studies' sector, with a direct interest in housing market analysis. In contrast, we have reviewed less evidence from an overtly economistic perspective, although some studies have been included (eg Hughes, 1999; Meen, 2006; Scanlon and Whitehead, 2005; but also Ball, 2004, 2006).

1.4.5 Some very new literature, but some dated

A rapid evidence assessment benefits from using a methodical search strategy. Because we contacted regional and local agencies in our search we have been able to review the newest evidence available, some even before publication. This means that our overall review has included the most up-to-date evidence available as well as solid studies from over the last 10 years.

We do suggest some caution, though, when looking at the date of studies. Housing markets change all the time; property prices and housing supply both fluctuate and public policy instruments are continually implemented and refined. The BTL market can change more quickly, as witnessed by the sudden rise in investors in housing market renewal areas. This means that evidence published as recently as 2002 can be considered out of date in some areas, and offer little insight into contemporary issues and pressures in those local housing markets, especially in the BTL sector.

2. Characteristics of investors and investment motives

We have found most evidence on the characteristics of investors and their investment motives. This section looks at these issues, first their overriding motives and then looking at three particular investor types.

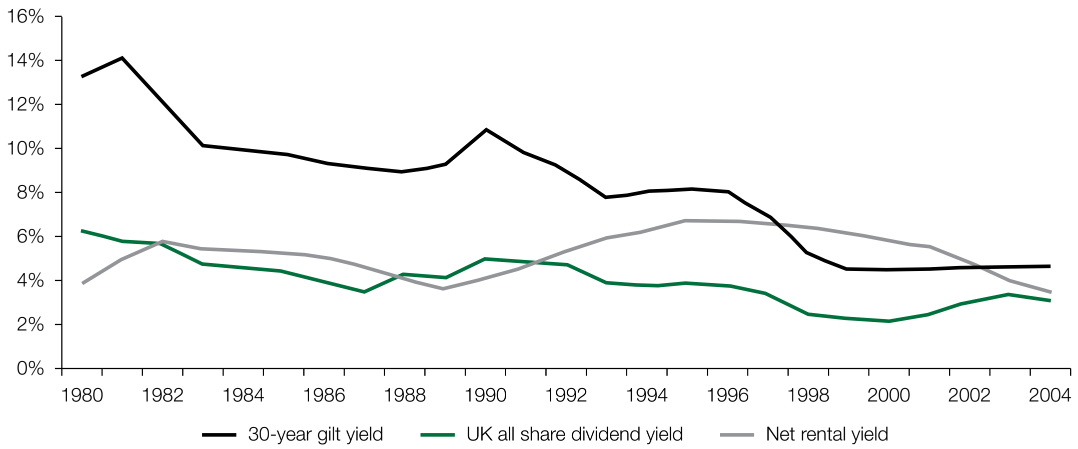
2.1 Investors seeking a financial return

Most studies point to the fact that many individuals have decided to become landlords. But what are their motives for doing so? There are many reasons people invest in property. The overriding motive for private landlords is to receive a financial return, either through rental income, capital gain or both. This financial motive is also increasing, up from 59% in 1994 and 1998 to 68% in the 2001 national survey (ODPM, 2003) to 72% among private individual landlords in the 2003 survey (ODPM, 2006).

BTL mortgages have given investors the means to borrow easily and at competitive rates. But the BTL phenomenon has done more by making it more socially acceptable to invest in property (Ball, 2004) or even socially desirable (ECOTEC and SURF, 2006). At a financial level, investment in rental property has also been attractive, especially when compared with other forms of investment. The index constructed by Rhodes and Kemp (2002) found total returns for residential property investors at almost 14% in 2000. Yet this was higher than the total return of 10% for all types of commercial property, minus 6% for equities, 9% for gilts and 6% for cash (Rhodes and Kemp, 2002, Table 4.1).

Data from the CML reinforces the strong return from property investment when compared with gilts and equities (Figure 2.1). This shows how net rental yield has been outperforming UK share dividend yield since 1992 and surpassed the 30-year gilt yield in 1998. By 2004, however, net rental yield was clearly moving downwards, making it a less attractive investment proposition in terms of rental income. This indicates that expected capital gains alone have driven the most recent wave of investment in the sector.

Figure 2.1 Yields on housing, gilts and equities



Source: CML (2006)

The comparison with other forms of investment is apt, as falling stock markets and companies closing final salary pension schemes have been suggested in the literature as two drivers for people to invest in residential property (eg Rhodes and Bevan, 2003). Ball (2004) suggests that this has given people greater confidence in managing their own long-term investment affairs rather than rely on financial market specialists, hence the rise in BTL investment. Landlords themselves see their investment as medium- to long-term. For example, the ARLA survey of landlords shows that over 2004 to 2007 most landlords expected their property investment to last over 16 years (ARLA, 2007). However, such intentions are bound to be adaptable to market pressures and changes, not just in property but in other assets as well.

We must also acknowledge, though, that some people become private landlords for other, non-financial reasons. For example, the evidence shows a rising trend of landlords acquiring property with the intention of living in it. In addition, some landlords buy properties to let to friends or family, sometimes rent-free, while organisational investors buy bought property to let to employees as part of a remuneration package. These last two types of landlord have little interest in the investment return of their properties and more concern for the use of their properties. There is also a small proportion of people who have inherited property (eg 14% of respondents in the Bridging NewcastleGateshead survey: Green et al, 2007). Although the letting can then result in financial gain, this is not the main reason they have acquired it.

The evidence suggests the following distinct groups of investors:

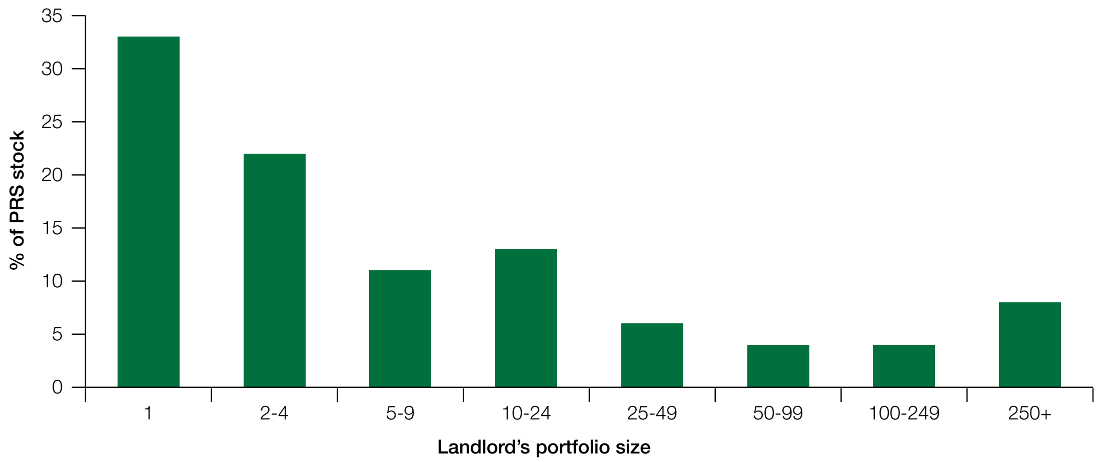
- small-scale, amateur landlords investing for their retirement;
- speculative investors seeking short-term capital growth, often in new-build apartments; and
- professional landlords living on rental income.

We outline these groups in more depth below.

2.2 Amateurs investing for retirement

The BTL phenomenon, helped by BTL mortgages, has encouraged a generation to invest in residential property. Yet much of this new investment is small-scale but long-term. Figure 2.2 shows the distribution of stock across the entire PRS by landlord's portfolio size. This clearly shows that the majority of stock (55%) is owned by landlords who own fewer than 5 properties. In contrast, 12% of stock is owned by large-scale investors with 100+ properties.

Figure 2.2 Distribution of private rented stock by size of landlord's portfolio



Source: CLG (2008)

Evidence of these small portfolios is also found in other surveys. For example, Scanlon and Whitehead (2004) found that most non-professionals with BTL mortgages owned one or two properties, and 69% of all these landlords owned less that six properties. Also, the survey of private landlords in the Bridging NewcastleGateshead housing market renewal area (Green et al, 2007) found that 57% of landlords owned 4 properties or less.

In addition to the small-scale nature of this investment, there has been a move away from institutional investors to private individuals owning PRS property. The last national survey showed that two-thirds (67%) of landlords were private individuals or couples (ODPM, 2006). This is mirrored elsewhere, for instance 81% of landlords letting to people on housing benefit described themselves as private individuals or couples (DWP, 2006). Furthermore, with such small portfolios, these landlords can fairly be described as 'amateur'. For example, the survey of BTL landlords (Scanlon and Whitehead, 2004) revealed that 68% had another full-time job and managed their investment in their spare time.

Rather than seeking short-term gain or rental income, this group of BTL investors are much more interested in long-term retirement planning (Rhodes and Bevan, 2003; Gibb and Nygaard, 2005). Many of these landlords plan to keep their investments and live on the rental income during retirement. Green et al (2007) also found that most landlords said they were in it "for the long haul", while the survey of BTL borrowers revealed that over 60% of landlords expected to stay in the residential market for at least 10 years (Scanlon and Whitehead, 2004).

2.3 Speculative investors in new-build

In sharp contrast to the long-term retirement planning of the above group, another group of BTL investors seeks to gain through short-term capital appreciation. Due to high levels of media attention this group is often most strongly identified with the rise of the BTL phenomenon. While this group of property owners is undoubtedly distinct, most studies show that speculative investors account for just a small proportion of the overall private rental market. They are, however, significantly concentrated in new-build apartments in city centres.

The ARLA survey of landlords showed that over 2004 to 2007 an average of just over 3% had bought for short-term capital gains (of less than five years) (ARLA, 2007). The national survey of landlords by the ODPM (2006) found that among new landlords nearly a third of properties would not be relet if they became vacant. This suggests that they too are short-term investors, potentially seeking rapid capital appreciation, though it could also indicate short-term investment for other reasons. Ball (2004) points out that investors in recent years will have seen significant year on year capital appreciation, unlike in previous and shorter boom-bust cycles. He suggests this will have been an incentive for those investors seeking short-term gains.

There has clearly been an attraction to certain types of property by these investors. Unsworth (2007), for example, found that the city centre market in Leeds between 2001 and 2004 was driven by speculative investors looking for short-term capital gain. Most apartments were bought off-plan with little regard for the quality of the product or the location. This type of investment is also reported in studies elsewhere in Yorkshire and Humber (Hickman et al, 2007), in Stoke-on-Trent (ECOTEC and SURF, 2006), Manchester and Sheffield (Allen and Blandy, 2004) and Glasgow (Gibb and Nygaard, 2005). The 2003 national survey of landlords supports this, finding that ownership of modern properties (build after 1964) and purpose-built flats was more common under new landlords than under longer-term ones (ODPM, 2006).

According to the analysis of the central Nottingham housing market (Knight Frank Residential Research, 2007), investors were more inclined to buy an unfinished product than owner occupiers and were further attracted to new-builds due to their lower maintenance, the potential for discounts for buying off-plan (up to 10% off), building warranties, the potential for more efficient management if several units were bought within one scheme and the ability to furnish and immediately rent a unit rather than have to invest time and money renovating an older property.

This type of investment is sometimes labelled 'buy to leave', with properties bought as an investment but with no intention of letting out. While this is going beyond the scope of our project (as there is no intention of letting out), the evidence revealed the existence of this sector. For example, the study of new-build homes in London (London Development Research, 2006) found that 16% of purchases were to the 'buy to sell' group (Table 2.1). But even in this study, the 'buy to let' group is three times as big, and expands further (to 58%) by the time of completion, as the majority of 'buy to sell' properties are sold-on to 'buy to let' investors. Yet the 'buy to leave' sector is an inherently unstable part of the market as decisions about the future of properties may be taken quickly if market conditions change.

Table 2.1 Who buys new homes in London?

Category	Sub-category	Number of buyers in London	Number of purchases (2005)	Number of purchases per buyer	% of total purchases
Buy to Let	Private individuals with <3 homes	3,000	4,500	1.5	28%
	Private individuals: larger portfolios	200	2,000	10.0	13%
	Investment funds	15	750	50.0	5%
	Total buy to let	3,215	7,250	2.3	45%
Buy to Sell	Total buy to sell	50	2,500	50.0	16%
Build to let	Developers	30	1,000	33.3	6%
	RSLs	10	500	50.0	3%
	Total build to let	40	1,500	37.5	9%
Owner occupiers	First home	4,250	4,250	1.0	27%
	Second home	500	500	1.0	3%
	Total owner occupiers	4,750	4,750	1.0	30%
Total London		**8,055**	**16,000**	**2.0**	**100%**

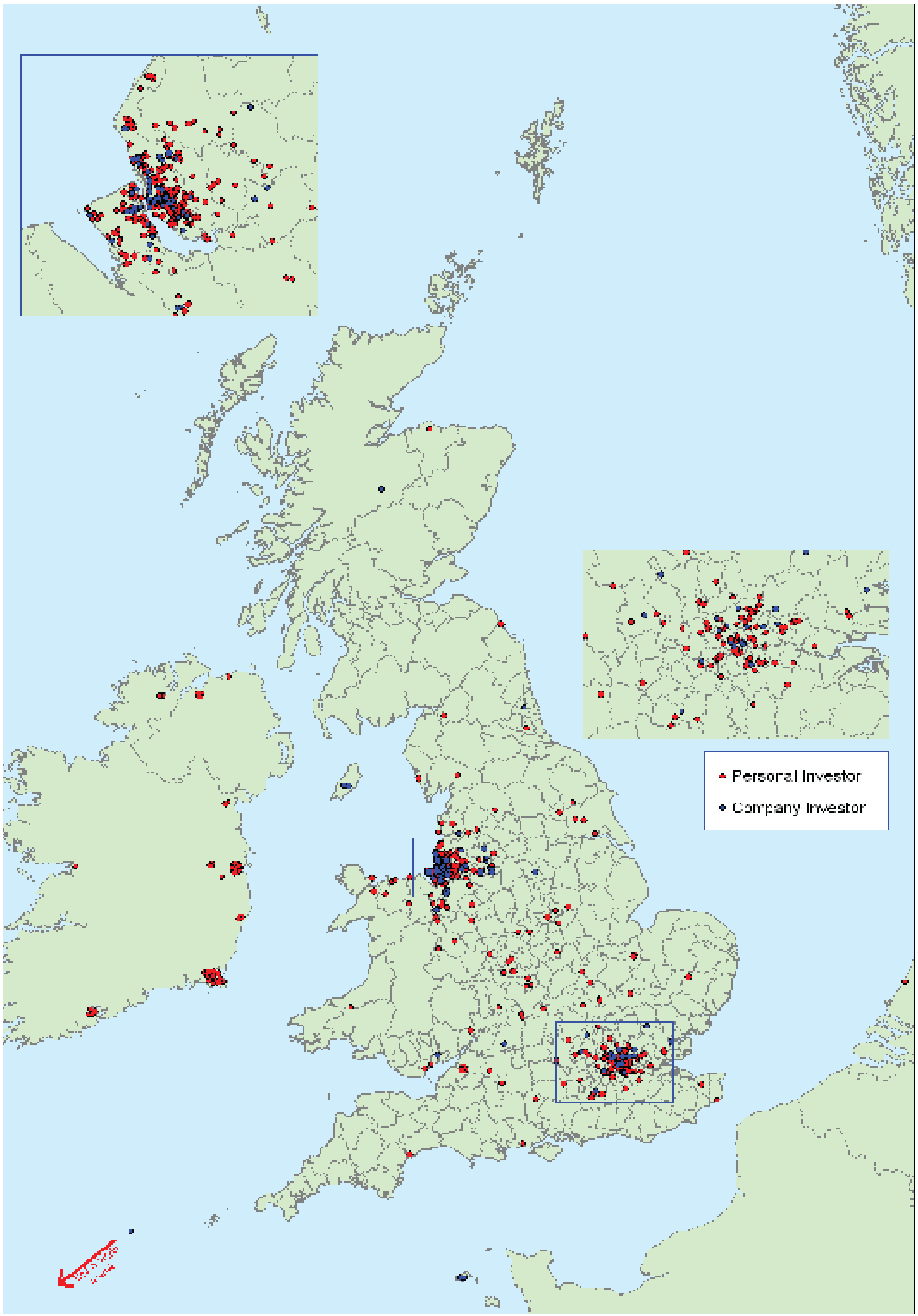
Source: London Development Research (2006)

This sort of investment in new-build properties, more common among newer investors, will inevitably lead to property price inflation providing that investors can sell at a profit. However, there may be saturation of the PRS in some markets which could lead to a fall in prices. According to Unsworth (2007), who was examining the development of the 'urban living' phenomenon in Leeds, the market has changed since 2004 – with higher interest rates, over-supply and declining yields – resulting in a tailing off of investor interest in this market. This is an issue that needs to be monitored closely.

The London Development Research (2006) study also points to high levels of activity from overseas investors in the capital. Quoting figures provided by Hampton International covering some 1,000 home sales in recent developments, 56% of investors were found to be from the UK and 44% from abroad, with the Middle East, South Africa, Western Europe and Ireland well represented among foreign investors. Foreign investors were found to be attracted to the UK market by the prevailing conditions of legal and political stability and by the strength of sterling. For Irish investors a regulation change concerning pension funds in Ireland was also a driver (Fox and Unsworth, 2005). This illustrates how the far removed from the housing market some of the pressures driving investment can be.

Another local study (ECOTEC, 2007), this time of Merseyside, also found significant levels of international investment in private rental property. Figure 2.3 shows the home or company address of investors of a sample of property in the NewHeartlands pathfinder. There are a significant number of personal investors from Ireland (particularly Wexford, Dublin and Cork) and company investors from off-shore tax havens (Guernsey, the Isle of Man and the British Virgin Islands). However, the study also shows that the largest concentrations of investors were from within Merseyside and in Greater London. However, the two studies quoted here may not be representative of the market as a whole.

Figure 2.3 Location of private non-owner occupiers in Merseyside sample



Source: Land Registry data of property sales in NewHeartlands Apr 01 to Mar 06 in ECOTEC (2007)

This BTL or buy-to-leave investment in new-build properties has had positive and negative consequences. It has financed much new-build development, contributing to an increase in housing supply (Rowlands et al, 2006) and greater choice for those who want to rent. But there are also disadvantages of such activity. First, there is evidence of owner occupiers being priced out of new-build developments, reducing the level of choice available to them (Allen and Blandy, 2004). Second, BTL investment has spurred developers to construct smaller, studio apartments (Knight Frank Residential Research, 2007; Rowlands et al, 2006). This is only a problem if people do not want them, which it would seem they do not (Unsworth, 2007). This is because rental yields can be higher in these units (Allen and Blandy, 2004) and because investors are also facing rising prices, so want properties they can afford.

2.4 Professional landlords living on rental income

The third key group of BTL investors is professional landlords seeking rental income. Scanlon and Whitehead found that almost a third (31%) of landlords owning more than 20 properties were acting under a company structure or as part of a partnership. These property owners are therefore closer to being letting agents – many in fact do operate as letting agencies – than private individuals.

The business model of those with large portfolios tends to be more focussed on generating a positive cash flow from rental income and is less preoccupied with short-term capital growth (Rhodes and Bevan, 2003; Scanlon and Whitehead, 2004). The 2003 national landlord survey found that over 60% of full-time landlords sought only rental yield from their investment, the highest of any type of investor (ODPM, 2006). The study of BTL borrowers by Rhodes and Bevan (2003) reiterated this and stated that for some of these landlords capital growth was an irrelevance.

Understandably, this group of investors is also more professional and knowledgeable about their work. For example, the CML survey (Scanlon and Whitehead, 2004) found that 'professional landlords' were generally more active in making changes to their portfolios than non-professional landlords. This is backed up by Rhodes and Bevan (2003) who found that full-time landlords were more commercially-focussed in disposing of underperforming stock and maximising the yield of their portfolios. More experienced landlords were generally felt to be in a stronger position to be able to weather short- or medium-term market fluctuations.

2.5 Regional variation found

The evidence suggests some regional variation in BTL investment levels, although the geographic coverage of the evidence is patchy. The CML-commissioned survey (Scanlon and Whitehead, 2004) found the amount of BTL activity in London, the South East and the South West regions to be disproportionate in relation to the population of these areas. Activity was found to be considerably less prevalent in the East of England, the Midlands, the North East and Yorkshire & Humber. However it should be noted that this survey sample was not strictly representative due to the self-selection of the 12 lenders who took part. This survey also revealed that a quarter of those landlords owning more than one dwelling had properties in more than one region.

Some studies have suggested a link between investment in a certain area and the type of stock available. New-build apartments have often been developed in city or town centres, part of the urban renaissance drive. The studies back up the generally held view that BTL investment (as well as buy-to-leave) has been prevalent in these developments. This is clearly evidenced in the study of London (London Development Research, 2006), particularly in east London where prices were lower, in Nottingham (Knight Frank Residential Research, 2007), Leeds (Fox and Unsworth, 2005; Unsworth, 2007), Manchester and Sheffield (Allen and Blandy, 2004), Liverpool (ECOTEC, 2007) and Glasgow (Gibb and Nygaard, 2005).

Housing market renewal areas and other lower-value areas with poor property conditions have developed a different BTL segment. According to Sprigings (2007, but echoed in CSR Partnership, 2004; Knight-Markiegi, 2006) much of the BTL activity in pathfinder areas concerned cheaper houses, especially in areas dominated by older terraced housing. This finding is also reported by Hickman et al (2007) in the case of Beeston Hill, an inner-city neighbourhood of Leeds with a high PRS and mainly pre-1919 terraced stock, in the study of Hull (CRESR, 2007) and of the Merseyside pathfinder (ECOTEC, 2007). This last one found a large concentration in low-value terraced housing, making up some three-quarters of private rented stock. Most of these properties in Merseyside are small, lack space, have no garden and are overcrowded. Because of its old age, much is likely to need repairs or improvements and offer poor thermal insulation.

While the above section discussed foreign investment into BTL, and numerous studies have talked about ‘flush’ investors from London buying elsewhere in the UK, many landlords still buy property in their local area. Rhodes and Bevan (2003) found that most landlords preferred to invest close to home, firstly because local knowledge was seen to be important in making shrewd investment decisions, and secondly because this made management and maintenance easier. A predominance of local landlords was also found in the studies of Yorkshire and the Humber (Hickman et al, 2007), Merseyside (ECOTEC, 2007), Newcastle and Gateshead (Green et al, 2007), East Lancashire (Pendle Borough Council, 2007), Stoke-on-Trent (ECOTEC and SURF, 2006) and Glasgow (Gibb and Nygaard, 2005). This last study also found that these local landlords, who were often small-scale, were generally committed to the market for the longer term.

2.6 Summary of key findings

The overriding motive for private landlords is to receive a financial return, with returns in residential property outperforming other forms of investment in recent times. Yet landlords have different motives for investing. The biggest group of BTL investors are small-scale and amateur, investing for retirement. These are most likely to expect to continue letting property over the medium- to long-term.

Speculative investors form a second group, though much smaller in size. They are seeking short-term gain through capital growth and are concentrated in new-build apartments. There is also overlap between this group and the 'buy-to-leave' phenomenon, with properties bought as an investment but with no intention of letting out. A concern for both groups is that there appears to be a saturation of the PRS in some markets which could lead to a fall in prices. Another worry is that such investment has encouraged developers to build small apartments, although there may not be sufficient household demand for such units.

The third key group of landlords are those who own large portfolios. These investors are more focussed on generating a positive cash flow from rental income and less preoccupied with short-term capital growth. Understandably, this group of investors is also more professional and knowledgeable about housing tax and finance.

3. Housing quality and voids

Going beyond the characteristics of investors and attraction to particular types of dwelling, this section considers the condition of properties in the BTL market and void levels.

3.1 Improvement to property conditions

Table 3.1 shows the rates of unfitness across all tenures from 1991 to 2001 (Kemp, 2004). This clearly shows that private renting has consistently held the highest level of unfitness (also found in ODPM, 2006), although fitness has increased dramatically over the decade, which coincides with the expansion of the sector. When broken down, the highest levels of unfitness are found in terraced houses and converted flats.

Table 3.1 Rate of unfitness by tenure in England, 1991 to 2001 (% of households)

Tenure	1991	1996	2001
Owner occupation	5.4	5.4	2.9
RSL rented	7.1	3.8	3.0
Council rented	6.8	6.8	4.1
Private rented	24.7	17.9	10.3

Source: Kemp (2004) Table 6.7

When looking at the alternative definition of housing quality, the decency standard, private rented properties again perform badly (Kemp, 2004). Breaking down the sector by sub-sector (Table 3.2), regulated tenants fare worst, with 74% living in non-decent housing. This is due to three reasons. First, the old age of many of the dwellings, with therefore more use and in need of more work. Second, the long history of rent controls has made it uneconomical for landlords to repair or maintain properties. Third, many of the tenants will be classed as vulnerable (in receipt of housing benefit and elderly) and will have weak bargaining power.

Table 3.2 Privately renting households living in non-decent housing in England

PRS sub-sector	% living in non-decent housing
Regulated	74
Non-regulated	49
Not accessible to public	37
All private tenants	49

Source: Kemp (2004) Table 6.8

Looking at the regional picture, it appears that property repair condition is poorer the further away it is from London and the South East (Crook, 2002). Urban and city centre properties along with rural dwellings in village centres and in non-residential locations are also in relatively poor repair. However, much of the data used for this study relates to the time before BTL mortgages, so must be treated with caution.

In terms of the link between landlord type and property condition the 2003 national survey (ODPM, 2006) noted that companies tend to own a higher proportion of older dwellings than other landlord types, and lower rates of decency. In contrast, dwellings acquired since 1999 – a fifth of dwellings – tend to be in better condition than dwellings already in the sector. Together, these suggest that the quality of properties in the PRS improves most with the replacement of poor-quality stock by dwellings in better condition rather than the active modification by landlords.

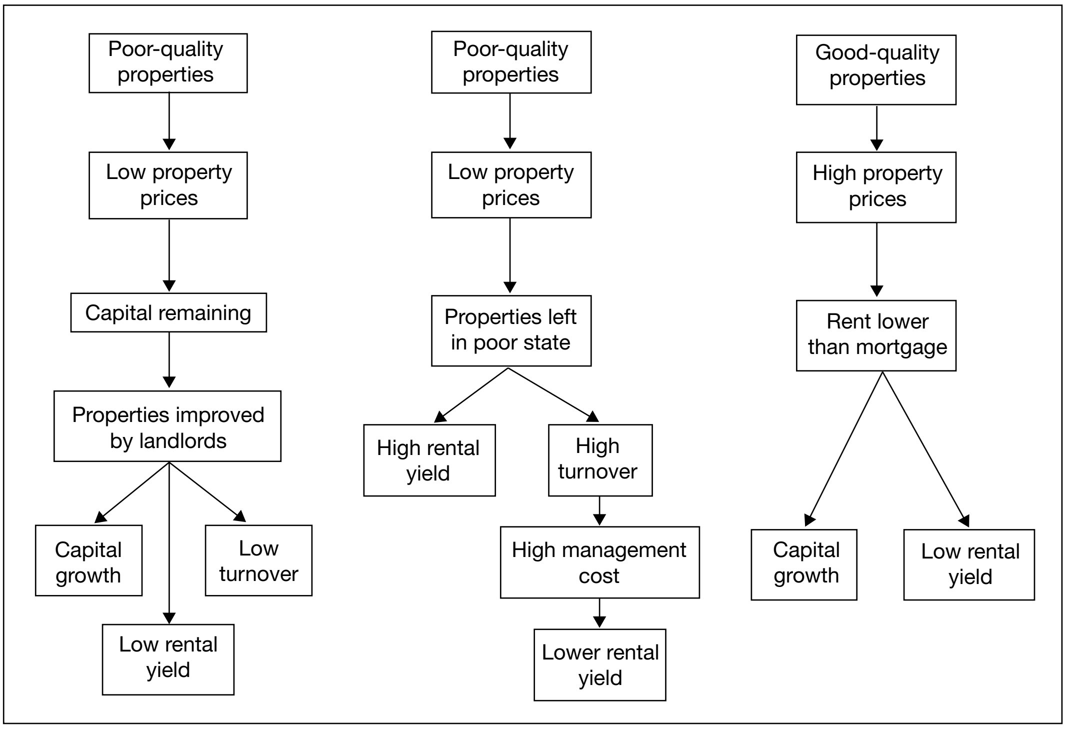
Crook (2002) found that the likelihood of work being undertaken and of the amount spent on the work also relate to the character and motivation of the landlord. He showed that addresses in the worst conditions were more likely to be owned by landlords who regard them as investments whereas those in the best conditions were more like to be owned by those who do not have investment motives.

One local level study, of Stoke-on-Trent (ECOTEC and SURF, 2006), found that there had been three distinct drivers of stock improvement for student landlords. First, Staffordshire University registration scheme initially set minimum standards but raised these standards each year. Second, the action of a few landlords had improved the condition of student rentals. One landlord was renowned for the quality of his stock and for raising the standard of student houses more widely. He had purposely positioned himself as a landlord of good quality stock, buying properties in a bad state but investing to improve them (also seen in Knight-Markiegi, 2006). This had the effect of encouraging other landlords to improve their stock. Third, Stoke-on-Trent City Council's landlord accreditation scheme had promoted membership by offering 50% property improvement grants to members. This action increased membership and got landlords to invest in the fabric of their properties sooner than they would have otherwise done.

The statistical study by Crook (2002) also looked particularly at the issue of stock quality and its relationship to rental income and property price. He found that returns, not rents, were related to property condition. The best condition properties tended to be better maintained than those in poorer condition. So annual spending on maintenance and minor repair was greater for properties in better condition, thus reducing the level of return. But vacant possession market values were higher among the better condition than the poorer condition properties. This means that some landlords will be interested in maintaining already good-quality homes, seeking capital growth and hoping for longer-term tenants, while others will be happy to receive rental income from poor-quality properties (Knight-Markiegi, 2006). Rhodes and Bevan (2003) labelled these two groups as "turnover minimisers" and "rent maximisers" respectively.

Knight-Markiegi (2006) summarised three distinct pathways for landlords and property conditions, which sums up much of this evidence (Figure 3.1). Although related to a low-value housing market, his findings appear transferable to other areas. One group of investors is interested in buying good-quality properties for higher prices, receiving a lower rental yield but hoping for capital gain. This group is closely aligned to the group of amateur but long-term landlords. A second group is interested in buying cheap properties but investing in them to minimise turnover by tenants and again seeking capital gain. The third group is happy to buy poor-quality properties and keep them so, receiving higher rents but also facing higher turnover, so higher management costs. This last group shares a short-term focus as the speculative, 'buy-to-leave' investors but is investing in poor-quality, rather than new and good-quality, properties.

Figure 3.1 Property condition and returns for landlords



Source: Adapted from Knight-Markiegi (2006)

3.2 Consistent level of voids

Evidence on vacancy periods and void rates is patchy but generally consistent. Two large-scale surveys of landlords (ODPM, 2006; DWP, 2005) found that at the time of interview some 6%–7% of landlords' properties were vacant. When looking at the duration of voids, most studies show that the average void rate in market renting (so ignoring 'buy-to-leave') is about one month per year (ARLA, 2007; Ball, 2004, which includes evidence from a variety of sources; Scanlon and Whitehead, 2005).

Ball relates this level of voids to the mobility of tenants. Evidence from ARLA (2007) shows that the average length of tenure for private tenants is some 15–17 months, which leads to continual churn in the sector. But this is partly what the PRS is about: providing quick and easy access to – and exit from – housing.

The 2003 national survey of landlords (ODPM, 2006) found that over half of vacant properties were non-decent, higher than all other properties let for less than six years. A study in one housing market renewal pathfinder (Green et al, 2007) found that landlords with city centre or waterfront apartments were most likely to report that some of their properties were empty, followed by landlords who owned a house converted into self-contained flats or into bedsits. When looking at regional differences, the evidence is very slight. Only ARLA (2007) covers this to some degree, showing that void rates were higher in 'prime central London' than 'elsewhere in the South East' and 'rest of the UK' from late 2003 (when the survey began) to late 2006; since then, though, rates had equalised between the areas covered.

While the level of voids is relatively consistent, empty properties of course cost landlords in lost rent. Scanlon and Whitehead (2005) found that among BTL borrowers the most common means of covering mortgage payments during void periods was to use savings. Surplus rents from other properties, and from the same property, were also significant. Providing that vacant properties are occupied in a relatively short time, there is little fear of BTL borrowers defaulting on their mortgage payments on a large scale. In fact, the level of arrears among BTL borrowers is lower than across the mortgage market as a whole (Thomas, 2006). But there would be a public policy concern if demand dropped or there was an oversupply in the BTL market.

3.3 Summary of key evidence

The private renting has consistently held the highest level of unfitness among all tenures, although fitness has increased dramatically over the decade. Improvement to property condition appears to happen more with new stock entering the market than by the active modification by landlords.

Some BTL investors are happy to hold on to poor-quality stock and obtain high rental yield, though have little interested in long-term capital growth. These landlords have been called 'rent maximisers', though may face higher voids. Another group of landlords often buys good-quality stock and invest to maintain this high standard or buys poor quality stock but improves it. These investors will receive better capital growth but reduced net rental yield, because of higher management and maintenance costs.

Evidence on vacancy periods and void rates is patchy but generally consistent. Some 6%–7% of landlords' properties appear to be vacant at any one time, and the duration of voids is about one month per year. These figures are probably affordable for BTL investors, but there would be a public policy concern if demand dropped or the BTL market became saturated with supply.

4. Investors and the wider housing market

BTL investment has made a significant impact on the PRS at large, now accounting for at least a fifth of the entire sector. But how have investors used BTL mortgages and what affect has all this had on property prices and homeowners? These issues are considered in this section.

4.1 Financing purchases with BTL mortgages

In assessing the proportion of the PRS with BTL mortgages, much of the literature has looked at the use of mortgages and other types of loan. ODPM (2006) states that almost half (46%) of landlords bought property using mortgages, though this rises to 54% for private individuals and even further to 64% for new landlords (those involved in renting for up to three years). This is in clear contrast to the situation in 1998, when three-quarters of PRS properties were bought with cash (ODPM, 2003). Investors are clearly attracted to borrowing, particularly BTL mortgages, to finance their purchases.

Scanlon and Whitehead (2005) provide further evidence about investors' use of BTL mortgages. They find that at least half of landlords had mortgages on all their properties, but many had unmortgaged property in their portfolio. Variable interest rates, particularly trackers, were the most common type, with most loan-to-value ratios between 26% and 75%; the maximum allowed by providers is now 85%. The vast majority of landlords had interest-only mortgages, which minimise the monthly cost. Another reason is that mortgage interest payments are tax deductible for landlords, while payments of principal are not. Their research also found that large landlords were more likely than small ones to have interest-only mortgages, suggesting a greater awareness of housing tax and finance.

Both the lending industry (eg Thomas, 2006) and some academics (particularly Ball, 2004, 2006) view BTL mortgages as a positive contribution to how investors operate. They particularly stress the optimal use of gearing, which is the relationship between invested equity and debt. In this sense, gearing in the property market is about reducing personal capital in investments in order to gain greater return. Using evidence from ARLA, Ball (2004) states that the total return for residential investors could double if 75% of the initial capital costs were borrowed instead of by paying cash for an outright sale.

Ball (2004, 2006) states that gearing is low in the PRS, and sees much potential for investors to improve their returns. He concludes that this demonstrates the lack of financial sophistication in the market. If there was more gearing, BTL mortgage lending could grow significantly in future, Ball believes, and the "private rental sector could operate on lower gross returns, if potential gearing and associated tax effects were adopted more effectively" (Ball, 2004, p34). While this latter point could well be true, it is dependent on investors being financially astute and changing their financial behaviour accordingly. This will be the case for some investors (as demonstrated in Hickman et al, 2007), but Ball himself labels many investors as "still relatively financially unsophisticated" (Ball, 2004, p34) and having "limited understanding of the benefits of borrowing linked to gearing and taxation" (Ball, 2006, p14). So, some investors will not use BTL finance to their full benefit.

For the lending industry, BTL borrowers are currently proving to be safer investors than across the whole mortgage market. This is demonstrated by lower levels of arrears. At the end of June 2006 the proportion of BTL mortgages in arrears of three months was 0.73%, compared with 0.96% for the wider mortgage market (Thomas, 2006b). As such – and no doubt due to the reduced numbers of first-time buyer mortgages – BTL lenders have recently relaxed their lending criteria. The typical maximum loan-to-value ratio has risen to 85% and minimum interest cover ratio falling to 125% (Thomas, 2006b); previously it was 80% and 130% respectively (Ball, 2004).

4.2 Some effect on property prices

Few of the studies provide empirical evidence on a direct relationship between BTL investment and house prices, and none has shown that BTL alone has increased prices. One local level study of Glasgow found that one in three landlords explicitly attributed the rental market investment to contributing to higher house prices, though a minority said it had no impact on prices (Gibb and Nygaard, 2005). But this is just anecdotal evidence from a small number of investors. A second local level study also includes similar anecdotal evidence: that the buoyancy of the PRS of Burngreave in Sheffield had contributed to house price inflation (Hickman et al, 2007).

However, Hickman et al (2007) also concluded that no single element had precipitated rapid house growth in the four case study areas they assessed. They call for a better understanding on the type of local housing market before pronouncing on the effects of BTL. Instead, what we have witnessed across England has been the parallel rise in property prices and growth of the PRS, particularly around BTL activity. Alternative reasons for the rise in property prices include weak housing supply, new demand as a result of in-migration, low rates of property transactions, rising incomes at a time of low interest rates and the deregulation of mortgage markets (Birch, 2007; Meen, 2006). On this basis, BTL investors are as much affected by rising property prices as they affect them.

There is stronger evidence that private landlords are attracted to low value properties, therefore making an association between BTL and property prices. ODPM (2006) found that areas with higher than average concentrations of private renting were most frequently found in areas where the housing market was healthy but house prices were modest. This association is further demonstrated by evidence from lenders that BTL investors bought properties cheaper than average prices, £78,000 compared to more than £100,000 (Pannell and Heron, 2001). This study also suggested that 80% of rented properties held by residential landlords was made up of flats and terraced houses. Gibb and Nygaard (2005) found consensus among stakeholders that BTL activity targeted one- and two-bedroom properties at the lower end of valuations. Taken together, this evidence suggests that a group of investors choose to buy relatively cheap property (as seen in the above section on property condition). Apart from being more affordable, cheaper property can lead to higher returns.

4.3 Competition with first-time buyers?

A big question for policy makers is the effect, if any, of BTL investment on owner occupiers. There is concern that investors have priced out first-time buyers. The evidence we reviewed is ambiguous. A number of the studies point to a more complex situation in the housing market. For example, a study into understanding housing demand (Hickman et al, 2007) concludes that there was no single ingredient that had precipitated rapid house growth in the case study areas. From the mortgage lending perspective, Thomas (2006a) also stresses the complexity between BTL and first-time buyers, highlighting that there is also movement from the PRS to owner occupation (also documented in Ball, 2004; Hickman et al, 2007). Thomas concludes that the ability of tenure to shift in response to changing patterns of demand should be welcomed as it provides much needed flexibility in a housing market prone to rigidity.

A number of studies state that rather than BTL pricing out first-time buyers, it is attitudes to homeownership that have changed. Thomas (2006b), for example, contests whether BTL investment has caused a reduction in first-time buyers or just coincided with a change in attitude among young households. He highlights the later entry of households into owner occupation. Although this is sometimes put down to affordability pressures, Thomas traces this trend back to the last housing slump in the late 1980s and early 1990s, when he argues that attitudes to homeownership among the younger generation changed. A study looking into tenure choices by the young (Andrew, 2006) stresses that increased debt for graduates is also a factor limiting the ability of young people to become homeowners. This viewpoint concludes that these social and economic trends have had obvious implications for tenure preferences, putting a premium on the flexibility that private renting provides while reducing the priority given to the security and asset acquisition involved in homeownership.

Tatch (2007) argues that a different reason, not BTL, has reduced the number of first-time buyers. Using survey data of mortgage lenders he points to the fact that the size of the 18-34 age group had fallen from a just below 15 million in 1991 to a low point of some 13 million in 2004 and that this demographic decline could be reasonably linked to the decline in the numbers of first-time buyers. Tatch found that first-time buyer activity has at worst remained stable since 2004, but at the same time affordability has become increasingly stretched. He estimated that in 2005 46% of first-time buyers under the age of 30 were likely to be getting substantial financial help (from parents and other relatives) to raise a deposit, a proportion which had steadily risen over the past decade. He concluded that such assistance entails the housing equity of mature owner occupiers being recycled back. Tatch considers the implication of this for the health of the wider housing market. In particular, something of a vicious circle could evolve as recycled equity would drive prices up further leading to an increasingly polarised housing market, with the children of parents who are themselves homeowners accounting for a progressively larger proportion of first-time buyers.

Two reports in particular argue that BTL has provided a demand-led alternative. Ball (2004) and Thomas (2006a) stress that there is greater demand for private renting today than in the past. Thomas states that demographic, financial and lifestyle factors have increased demand for private rented accommodation, such as increasing levels of divorce and separation, people remaining single for longer and couples being increasingly likely to cohabit rather than marry. In addition, rising numbers of students and new immigrants also require a flexible tenure to meet their housing needs. These two groups, along with other low income but renting households, were also important to the PRS case study of Beeston Hill in Hickman et al (2007) and in other studies (eg ECOTEC, 2007). In this light the BTL sector is seen as a vehicle for facilitating growth in the private rental housing stock to meet increasing demand.

Ball (2004) agrees with this, stating that the development of BTL has widened market choice, particularly for younger households who have high mobility and do not have the financial circumstances to allow access to owner occupation. Furthermore he argues that renting for many younger households over the past decade has represented the lower risk, high current-consumption option. Ball also believes that the development of BTL has increased competition in the PRS leading to higher standards of accommodation, contributing to more people wanting to rent. So for Ball and Thomas, the expansion of the PRS and the BTL phenomenon is a natural and healthy market response to demand pressure.

A very recent study (Wilcox, 2007) also suggests that the PRS is an affordable alternative – sometimes one of choice – for young people. It stresses that the sector should be considered ‘affordable housing’ alongside efforts to make owner occupation affordable. Wilcox details how private rents in England and Wales in 2006 represented less than two-thirds of the level of house purchase costs. This is because private sector rents have simply kept pace with earnings growth since 1994, whereas house prices have risen much higher. He concludes that a substantial proportion of younger working households unable to buy locally could nonetheless afford to rent.

Other studies point to a different interplay between BTL investment and first-time buyers. There is the competition in small new-build apartments, discussed above, and city centre or waterside developments. This is probably the strongest case for BTL investors pricing out potential owner occupiers. However, much of the BTL investment is in other types of stock and in different parts of the housing market, so not directly competing. The Beeston Hill case study in Hickman et al (2007) is a good example, where stakeholders said that new investor interest was largely driven by a buoyant local demand for rental housing in combination with cheap house prices. Rather than pricing out first-time buyers, the study reports that local landlords were being squeezed out by new landlords, a process welcomed by one respondent due to property improvements being made by these newcomers.

Because of the focus of our study (on BTL rather than owner occupation), we found little mention of the lack of housing supply leading to price rises, although a few studies (eg Ball, 2004; Birch, 2007; Meen, 2006) do acknowledge this process. Nor have we found empirical evidence about BTL investment in former right-to-buy estates. These inevitably convert an owner occupied home into a privately rented one, but such properties are more likely to house somebody in place of social renting than providing competition for first-time buyers.

4.4 Summary of key findings

The lending industry and some academics view BTL mortgages as a positive contribution to how investors operate. Some state that gearing is low in the PRS, and see much potential for investors to improve their returns if they borrower further. For the lending industry, BTL borrowers are currently proving to be safer investors than across the mortgage market, as BTL borrowers have lower levels of arrears.

Few of the studies provide empirical evidence on a direct relationship between BTL investment and house prices, and none has shown that BTL alone has increased prices. Instead, a number of studies conclude that the housing market is more complex, with no single element precipitating rapid house growth. There is stronger evidence that private landlords are attracted to low value properties, therefore making an association between BTL and property prices.

There is also concern that investors have priced out first-time buyers. Yet the evidence is ambiguous. A number of studies state that rather than pricing out first-time buyers, BTL is providing a demand-led alternative at a time when attitudes to homeownership have changed. Other studies point to a different interplay between BTL investment and first-time buyers. The strongest case for BTL investors pricing out potential owner occupiers is found in the competition for small new-build apartments and city centre or waterside developments.

5. Future prospects

Of great importance to any discussion about BTL are the future prospects of the sector. A large amount of the literature has looked at this. In this section we break the subject down into the buoyancy of the market, the affect on landlord behaviour and the need for ongoing demand for private rented properties.

5.1 Buoyant investment for the medium to long term

We have already discussed the range of motivations of BTL investors. Some seek short-term gain while others are planning for retirement. Yet most studies found that the majority of landlords regarded their investments as medium- to long-term. For example, the 2003 national survey of landlords found that 81% of landlords intended to still be letting property in five years' time, while 68% expected to in 10 years' time (ODPM, 2006). The survey of BTL borrowers also found long-term plans, with more than 60% stating they expected to stay in the residential rental market for more than 10 years (Scanlon and Whitehead, 2005).

A number of the studies have also looked at what landlords would do if the property became vacant. In the 2003 national survey over three-quarters (77%) of landlords said they would immediately relet their property if it became vacant tomorrow (ODPM, 2006). This is slightly higher than in 2001 (ODPM, 2003). When looking over a longer timeframe, most landlords expect to hold a similar size portfolio. The 2003 national survey found that 55% of landlords expected to keep the same number of dwellings for the following two years (ODPM, 2006), broadly the same as BTL borrowers over the following 12 months (Scanlon and Whitehead, 2005). The survey of members of ARLA (2007) also shows that the majority of landlords were maintaining their same portfolio throughout the survey period (from late 2004 to early 2007). This evidence again shows that most landlords see their investment as medium- to long-term.

In most studies that reported it, more landlords intend to buy properties than sell them. The 2001 national survey found that one in five landlords (21%) expected to acquire more property to rent out in the next two years compared to 11% who expect their renting activities to contract (ODPM, 2003). The 2003 national survey found an even greater ratio (ODPM, 2006). The survey of BTL borrowers found that 38% planned to increase the size of their portfolio while just 6% planned to decrease it or leave the market altogether (Scanlon and Whitehead, 2005). The quarterly survey of landlords by ARLA (2007) also found a stronger intention of buying more BTL properties, with the majority of landlords saying so. These last two surveys show a stronger likelihood of increasing portfolio size perhaps because they looked at a shorter timescale, just a year, and asked BTL borrowers rather than all types of landlord. These investors, who are clearly engaged with housing finance (through BTL mortgages), may be more likely to increase their activities than other types of landlord.

5.2 Interest rates and personal finance affect landlord behaviour

Some studies went beyond this and asked landlords what changes might prompt a change to the size of their portfolios. The survey of BTL borrowers (Scanlon and Whitehead, 2005) found that stable or low interest rates, stable or rising house prices and very good rental yields were seen as primary reasons for increasing one's investment portfolio; rising interest rates and insufficient rental income to cover mortgage payments were identified as primary reasons for decreasing holdings. With a bigger PRS and greater use of mortgages, there is a concern that BTL borrowers would amplify any market downturn by exiting the market all together if faced with the possibility of declining capital values (CML, 2004). But this conflicts with the stated intentions of landlords to invest for the longer term and hold on to property in a downturn, the CML briefing states. This is echoed in the survey of BTL landlords by Scanlon and Whitehead (2005) and by ARLA (2007). The latter reports that the overwhelming majority of landlords said they would not sell their properties if prices were to fall, between 82% and 90% throughout the period of the survey (mid 2004 to early 2007).

The in-depth research by Scanlon and Whitehead (2005) reported a range of previous studies to suggest that landlords' behaviour is cyclical rather than counter-cyclical: landlords acquire property in a rising market and dispose of it in a falling market, rather than using the opportunity to stock up at low prices. However, their study suggested that having low gearing might encourage landlords to hold on to the properties even if prices fall. But the authors warn that landlords' predicted behaviour and their actual behaviour might not be the same, and that new entrants may not behave as their predecessors did (as the warning on investment products always states: 'past performance is no guarantee of future performance').

A number of studies conclude that the risks are greatest for new investors. These are most likely to be inexperienced in the letting process, have higher financial risks (CML, 2004) and experience slower capital growth (Hometrack, 2007). The survey of BTL borrowers found that nearly a third of non-professional landlords and two-fifths of landlords with only one property reported a worsening personal finance situation as a reason for decreasing their portfolios (Scanlon and Whitehead, 2005). These inexperienced landlords were also twice as likely to say they would sell because of stagnating or falling property prices as experienced landlords. This analysis suggests that if there were a sustained property price downturn, it would be the most recently bought BTL properties that would come onto the market. This could be unsettling if they are concentrated in particular property 'hot-spots' and would be painful for these investors.

5.3 Importance of demand for private renting

Hometrack (2006) estimates that demographic, economic and social factors will combine to increase demand for private rented housing over the next 15–20 years. Based on demographic projections alone, there is potential demand for an additional 600,000 private rented homes by 2021. However, high levels of in-migration to the UK, persistently high house prices and changing attitudes towards renting are likely to result in total demand exceeding this number. The article states that most future demand will come from two key groups: the ‘mid-market’ segment that would otherwise be in owner occupation; and ‘displaced’ demand from those in housing need who are unable to access the social rented sector. With expectations of such large growth in demand, the article concludes that the supply of rented accommodation is the biggest problem and where the focus of attention should lie. The recently published report by the NHPAU (2007) also stresses the need for increased supply, even higher than current targets.

In contrast, Ball (2004) believes that demand for private renting will decrease in future, especially with the decline in the young adult age cohort, particularly in South East England and London. However, this may be tempered by the lack of affordability of owner occupation pushing young households into the PRS. But he believes that a large-scale increase in the PRS can only be expected in the near future if social housing is reformed, though an unlikely prospect given the Housing Green paper. Yet he believes that the tendency to introduce regulations whenever there is a problem could reduce the level of investment in BTL.

There is considerable uncertainty over the likely future demand for private renting. What is clear, though, is that unless demand for rented properties is maintained the PRS will not be able to sustain current levels or grow further. On balance, it appears that demand will increase because of affordability problems in owner occupation and quite large changes to the population structure from new migrants (documented more recently than Ball was writing in 2004). So long as supply has not become saturated, BTL will have a place; but where an over-supply has already occurred, a short-term contraction may take place.

5.4 Summary of key findings

Most studies found that the majority of landlords regarded their investments as medium- to long-term and that landlords plan to maintain the size of their portfolio. But more landlords, particularly BTL borrowers, intend to buy properties than sell them, showing confidence in the market.

One in-depth survey of BTL borrowers found that stable or low interest rates, stable or rising house prices and very good rental yields were seen as primary reasons for increasing one’s investment portfolio; rising interest rates and insufficient rental income to cover mortgage payments were identified as primary reasons for decreasing holdings. This is used to show that landlords’ behaviour is cyclical rather than counter-cyclical.

A number of studies conclude that the risks are greatest for new investors. These are most likely to be inexperienced in the letting process, have higher financial risks and experience slower capital growth. If these landlords have to sell up, this would be unsettling if they are concentrated in particular property 'hot-spots' and would be painful for these investors.

There is considerable uncertainty over the likely future demand for private renting. But on balance, it appears that demand will increase because of affordability problems in owner occupation and quite large changes to the population structure from new migrants. So long as supply has not become saturated, BTL will have a place; but where an over-supply has already occurred, a short-term contraction may take place.

Although unreported in the published studies, the second half of 2007 there has certainly witnessed tremors in the housing market. The crisis around sub-prime mortgage lending in the United States has led to an international credit crunch, the run on Northern Rock and the fall in property prices in much of England have all increased the volatility of the market. Investors must surely be nervous and potentially deterred from buying additional properties until the picture is clearer.

6. Conclusions

Having outlined the literature, this section synthesises the evidence and draws out the implications for public policy. It also highlights where the evidence has been weakest and suggests further research to fill these gaps.

6.1 The growth of BTL

The PRS is today bigger in both number and as a share of all households than its lowest point in the late-1980s. BTL mortgages, introduced in 1996, have made a significant contribution to this rise. They have brought a new generation of investors into the residential property market, spurred by attractive returns in comparison to traditional pensions and the equity market. BTL has helped to make it socially acceptable to invest in property. Most recently, BTL makes up at least one fifth of the entire PRS, though probably more, as landlords realise the potential for higher returns through mortgaging their properties. Some commentators believe that this gearing could go even further, taking even more stock into borrowed equity. The lending industry is also keen to promote BTL borrowing, and sees it as a safer choice than across the mortgage market.

6.2 Stability and risks for amateur investors

But there are different motivations for buying and letting property, mostly driven by a desire for a financial return. The biggest group of investors are small-scale and amateur landlords, investing in few properties and seeking a return for their retirement. Because these people regard their investments as medium- to long-term, they provide stability to the sector. However, their inexperience in the rental market can pose some risks, especially as many have personal finance tied up in their properties. For new investors, the risks are even greater, as these landlords will be most inexperienced, have higher financial risks and experience slower capital growth than longer-term investors. This suggests that if there were a sustained property price downturn, it would be the most recently bought BTL properties that would come onto the market.

6.3 Speculators can spur and unsettle the market

A small proportion of BTL investors have made speculative investments for short-term capital growth. They are significant in new-build apartments in city centre and waterside developments. Such large investment has financed much of the continual development, crucial in meeting an increased level of housing supply. But it has also priced out potential owner occupiers from some developments and influenced the type of apartment built, boosting the number of smaller units.

This market segment has also seen overlap between real BTL investors and those labelled ‘buy-to-leave’ investors, those who buy property with no intention of letting it out. The latter have also been attracted to new-build developments as they offer lower maintenance, potential discounts if bought off-plan, greater security and the hope of high capital growth. However, at least one study has suggested that this type of investment is tailing off in Leeds because of higher interest rates, over-supply and declining yields. This is an issue to monitor closely in similar housing markets across the country.

6.4 Professional landlords ride the storm

A third group of BTL investors is professional landlords living on rental income. They are closer to letting agents than private individuals, act in a more professional way and are knowledgeable about housing tax and finance. The analysis suggests many of these are remortgaging their properties using BTL loans, often with interest-only mortgages. Such landlords are generally felt to be able to weather short- or medium-term market fluctuations.

6.5 Cyclical behaviour from landlords

Landlord behaviour appears to be cyclical rather than counter-cyclical: landlords acquire property in a rising market and dispose of it in a falling market, rather than using the opportunity to stock up at low prices. Landlords generally feel confident about their portfolios, particularly BTL borrowers, and more plan to increase than decrease their stock. However, fallout from the Northern Rock problems and the international credit squeeze in the second half of 2007 may affect investor behaviour. One in-depth study found that stable or low interest rates, stable or rising house prices and very good rental yields were seen as primary reasons for increasing one's investment portfolio; rising interest rates and insufficient rental income to cover mortgage payments were identified as primary reasons for decreasing holdings. But the report also warns that landlords' predicted behaviour and their actual behaviour might not be the same, and that new entrants may not behave as their predecessors did.

6.6 Property conditions are improving

Private rented stock has consistently held the highest level of unfitness among all tenures, although fitness has increased dramatically. Improvement seems to come from the replacement of poor-quality stock with dwellings in better condition, rather than the active modification by landlords. Some landlords are happy to buy good-quality properties and maintain these high standards, gaining better capital growth in the long term. Others – described as 'rent maximisers' – seek short-term income by letting out poor-quality properties and have little interest in the long-term state of the stock. A third group of investors has actively bought poor quality stock for low prices but invested in this to minimise turnover and improve capital growth.

6.7 The housing market is complex

House prices are driven by a complex interplay of factors. BTL investment will be one of these but not the sole or even necessary the major factor. The evidence shows the strongest direct relationship between BTL and new-build apartments, along with the knock-on effect of pricing out first-time buyers. The low price of old terraced stock in housing market renewal areas has been an incentive for BTL investment, which will have helped stimulate prices in these locations, though in itself causing affordability problems for low- to medium-income households seeking to buy. But alternative reasons for the rise in property prices include weak housing supply, low rates of property transactions, rising incomes at a time of low interest rates and the deregulation of mortgage markets.

While some commentators believe that BTL has priced out first-time buyers, the evidence also presents an alternative viewpoint. This one sees BTL as a healthy market response to demand pressure. Young households, students, new migrants and people displaced from social housing have all increased demand for private renting; demographic, financial and lifestyle factors have also increased demand; while attitudes to homeownership have changed and affordability has deterred potential owner occupiers. On this basis, the PRS acts as an affordable alternative to young people in particular. So long as demand continues and the BTL market does not become saturated with supply, BTL will have a place; but where an over-supply has already occurred, a short-term contraction may be necessary and this will be intensified if others are coming through he planning pipeline.

6.8 Future research is needed

This large-scale review of the BTL market has covered a lot of ground. But we have found the evidence to be patchy. While there is strong evidence on characteristics of investors, the housing markets they invest in and the future prospects for the sector, the biggest gaps are empirical evidence on whether BTL investment is 'pricing out' first-time buyers and evidence around the supply and quality of BTL housing stock. Because of the fast pace of change in the BTL sector, reports published as recently as 2002 can also be considered out of date. There are also gaps in the geography covered.

We suggest that future research on BTL should therefore look at:

- The extent to which BTL investment has 'priced out' first-time buyers, and how this interacts with the local housing market. This is particularly important because of the continued affordability gap for many first-time buyers. Certain housing markets are more likely than others to face these problems, such as city centres, regeneration areas and new-build developments.
- The motivation to invest in property maintenance by newer landlords, and their use of managing agents. There links into the decent homes agenda and is coupled with the risk that inexperienced landlords are less able to manage their properties and to maintain stock in good condition. In addition, the role of managing agents has been little studied.
- Demand for private renting among new groups, particularly A8 migrants. This has important links with spatial planning policies, especially around population numbers. Because the PRS offers such easy access to housing, migrants are disproportionately located in the sector, with particular housing markets facing large waves of migrants. These tenants are hard to reach, so special methods should be used to consult with them.

- Geographical gaps, particularly in cities with large student populations and in coastal areas, where private renting is higher. Such an approach allows national and regional resources to be targeted at those areas most likely at risk of change in the PRS. There will undoubtedly be much local knowledge from a range of stakeholders, yet such rich information is rarely collated in a systematic way.
- Local authority-level systems to monitor developments and trends in the PRS, to ensure that they understand the changing market – these should also use a common methodology to compare across regions. Some studies we have reviewed have suggested such systems (eg ECOTEC and SURF, 2006), but many local authorities require help developing the tools to monitor their local market on an ongoing basis.
- Updating old evidence, such as Crook (2002), Rhodes and Kemp (2002) and Rugg et al (2000).

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Annex 1: Search strategy

Search strategy

One reason a rapid evidence assessment is more thorough than a literature review is the use of a robust search strategy. This should be transparent and explicit. Here are the various ways we sourced evidence, including any keywords used:

- Joseph Rowntree Foundation reports (with various keywords used);
- Ingenta Connect (searched on “private rented sector” and “buy to let”);
- Google Scholar (searched on “buy to let”);
- IDOX (searched on “private renting”, “buy to let”);
- CML (annual statistics, research reports);
- ARLA;
- RICS;
- Hometrack;
- IPD;
- CLG and DWP publications;
- contact with all regional assemblies;
- contact with housing market renewal pathfinders;
- contact with selected city councils (Nottingham, Bristol, Leeds, Birmingham – chosen for having large student populations and likely to have commissioned research);
- references from the National Housing and Planning Advice Unit;
- references from Nigel Sprigings (2007);
- references from Adam Knight-Markiegi (2006);
- studies we already knew about; and
- methodological references (eg Cochrane Collection).

Annex 2: Review template

Buy-to-let literature review template

This is the template for completing the rapid evidence assessment of literature on the buy-to-let housing market. It provides the framework for appraising the quality of the work as well as the contents and conclusions of literature. Please complete one form for each text and each relevant research question; so for a text that covers multiple questions you will have multiple sheets. There are some more guidelines below to help complete this form.

Our research questions

Our primary research question	
Secondary issues	
Other research questions covered	

Literature

Title	
Author	
Date published	
Publisher and location/journal	
Research aims/questions	
Geographical scope	
Interest in subject	
Methodology	
Limitations of study	
Overall quality of study	
Relevant key findings (page numbers for data/quotes)	
Relevant recommendations (including further research)	

To guide the completion of the form, we need to critically appraise each piece of literature on the following basis:

- the research aims and questions that prompted the original study;
- the geographical scope of the material (eg national, regional, local);
- the interest in the subject (eg independent evaluator, industry representative, local authority, private consultancy);

- methodology (eg primary or secondary evidence, quantitative, qualitative, sample used (eg who selected, how selected), actual methods (eg interviews, survey), discussion of methodological weaknesses, etc;
- limitations of the study, such as:
  - lack of explicit methodology;
  - appropriateness of methods and statistics;
  - low sample size and poor selection;
  - low response rate;
  - data is no corroborated or findings tested (eg not using different data types, not triangulating findings);
  - data is not broken down (eg only national level, no split by type of landlord);
  - missing data;
  - data is weighted, especially if not explained;
  - overuse of secondary data;
  - selection bias in terms of data presented (eg industry representatives only showing positive results, campaigners only showing negative results);
  - certain groups are not included in the study but should have been (eg landlords, tenants); and
- the overall quality of the study (ranked high, medium or low), based on all of the above.

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