

## RESEARCH ARTICLE

## Three challenges facing private landlords

21 JULY 2023

ARTICLE

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A triple whammy of financial and regulatory pressures will drive a wedge between smaller, more indebted landlords and larger investors with less exposure to mortgage debt, who are better placed to capitalise on future rental growth

There are three challenges facing private landlords over the coming months and years;

The increased cost of mortgage finance

Increased energy efficiency requirements

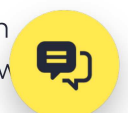
The impact of the Renters (Reform) Bill

Together they are likely to curtail investment in the private rented sector and, in some cases, cause landlords to reassess the size and make-up of their portfolio. While some landlords will sense an opportunity to pick up rental stock brought to the sales market, others will choose to exit the sector altogether.

Overall, this is likely to mean a continued undersupply of homes for rent and continued upward pressure on rental values. This is likely to benefit committed landlords who have a low or moderate exposure to borrowing, particularly if they hold their investments in a corporate structure.

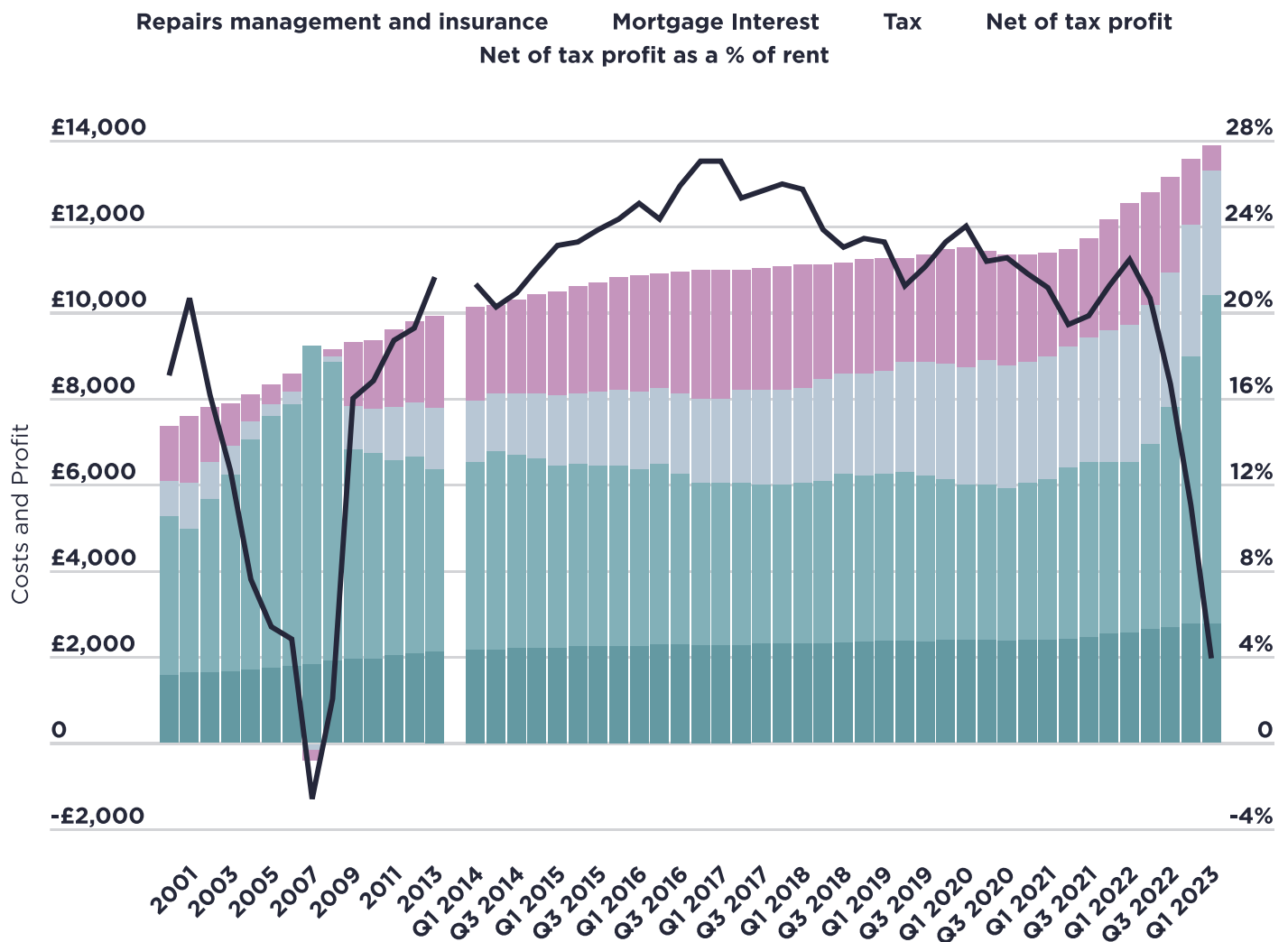
### 1. Increased mortgage costs

The cost and availability of Buy to Let mortgages has been fundamental to the growth in investment in residential property we have seen in Britain over the past 25 years. But now



Our recent analysis suggests that in the first quarter of 2023 (prior to the most recent rise in mortgage rates), the average net profit for a 40% taxpayer buying with a 70% loan-to-value mortgage had fallen to below 4% of the gross rent received. That is the lowest margin since 2007 and well below the 23% seen between 2014 and 2017. It reflects the extent to which higher mortgage costs have been compounded by restricted tax relief on mortgage interest for those who hold property personally.

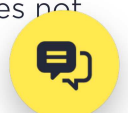
### ***Finances for the average mortgaged Buy to Let investment on a 70% LTV, interest-only mortgage held personally by a higher-rate tax payer***



**Source:** Savills Research

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Of the three challenges, difficulties in making mortgaged Buy to Let wash its own face financially are likely to be the biggest driver of sales by Buy to Let investors. But this does not mean a wholesale exodus from the sector.

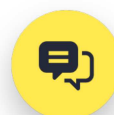


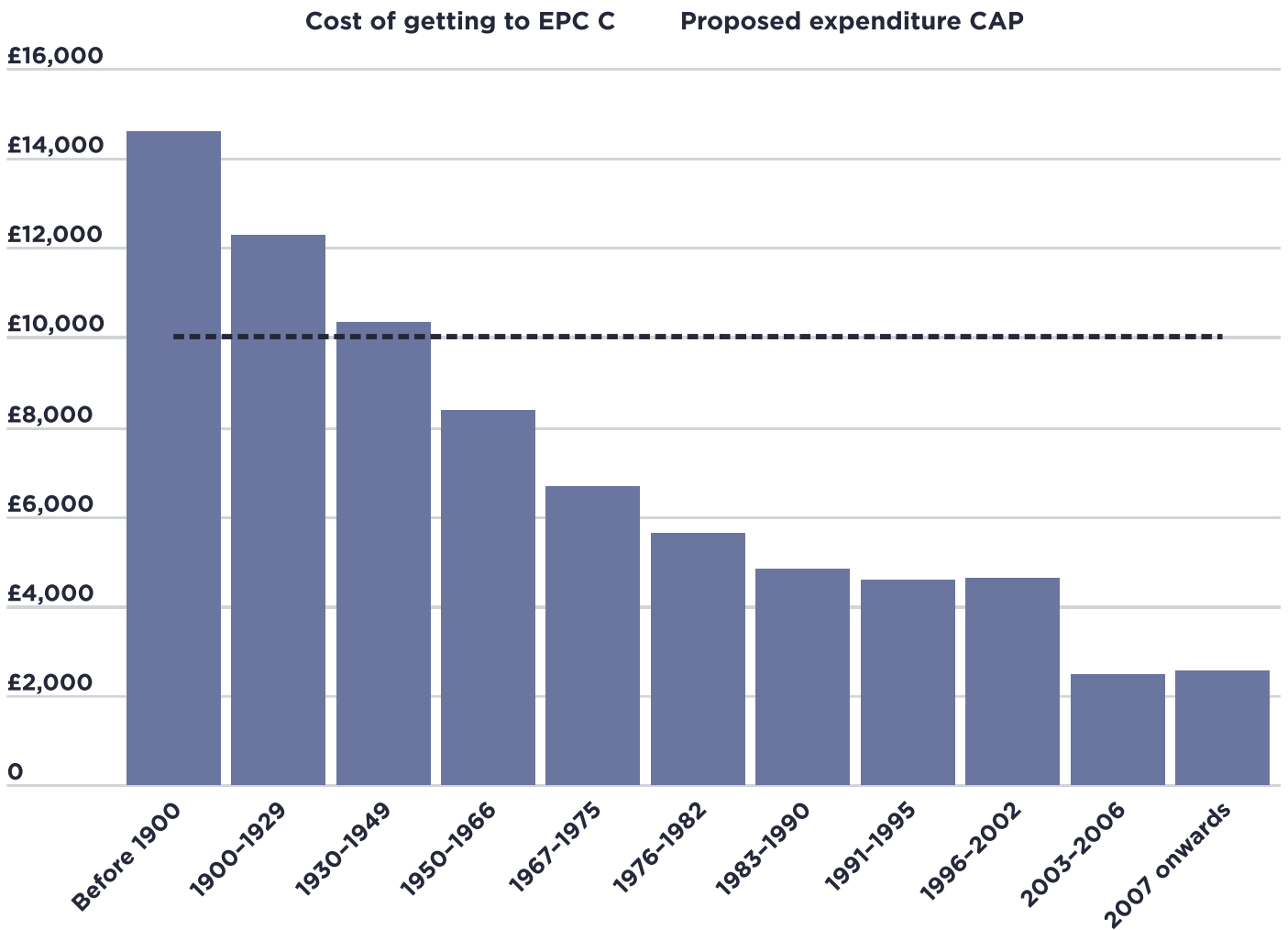
## 2. The EPC challenge

While it is still unclear exactly when higher energy efficiency standards will be imposed on landlords, it is only a matter of time before EPC C replaces EPC E as the minimum in most cases. Of the 728,138 EPC certificates issued for properties in the private rented sector between 2021 and 2022, 51% were still below EPC C. In properties built before 1950, that increases to 71%.

Improvements have already been made. Low-cost, 'quick wins' such as low energy lighting, draft proofing and installing heating thermostats have been most widely undertaken. Equally, we have seen a large fall in the number of recommendations to install more efficient condenser boilers, as older boilers have progressively been replaced once they have come to the end of their useful life. But much remains to be done, particularly around insulation and reducing the reliance on the gas boiler.

And so our analysis indicates that the total cost of bringing private rented homes up to a minimum EPC C rating sits at around £30 billion. Even if required expenditure is capped at £10,000 per property, this could result in total costs for landlords across the UK of £25 billion. But importantly, portfolio landlords will be able to apply what they learn from one property to the next and enjoy economies of scale to reduce their cost exposure.





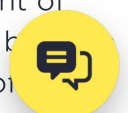
Source: Savills Research

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### 3. The Renters (Reform) Bill

Last but certainly not least, the Renters (Reform) Bill represents the biggest change in landlord and tenant legislation for residential property since the Housing Act 1988. It will bring an end to Section 21, namely, the ability to serve two months' notice to recover possession at the end of a fixed-term tenancy.

That means, where the rental payable for a property is under £100,000 per annum and it is occupied as a tenant's main residence, the tenants will have greater rights of ongoing occupation. As a result, landlords will have more exposure to a change in tenants' circumstances, even though grounds to recover possession of a property on non-payment of rent or other tenancy breaches will be strengthened. Smaller landlords, in particular, will be expected to protect against this, with more robust checks on their tenants' financial security, use of



Importantly, whatever the scale of their investment, landlords will still be able to secure vacant possession of a let property where either they (or a close family member) intend to occupy it or they have a genuine intention to sell. That will protect the liquidity of their investment, but there will still be other management implications.

High amongst these will be a different approach to rent reviews. Landlords will need to propose a rental increase through servicing a formal notice. Tenants will have the ability to refer the matter to a tribunal where they believe it doesn't reflect the market value of the property. That will place a greater onus on landlords to prove the rent they propose is a true reflection of what a property will let for on the open market.

Practically, that process is likely to be easier where the rent is benchmarked to the market before the legislation is brought into effect. Similarly, where a property is currently set at a concessionary level, that should ideally be expressly acknowledged by both parties.

### Three is the magic number

Each of these three challenges will have individual implications for current and prospective landlords, but together they are likely to mean the supply of available rental stock remains tight. And that has implications for tenants too. Those in a property that meets their needs over the medium term will benefit from greater security. However, those looking for a property to rent are likely to find themselves in a highly competitive market; one which inevitably will favour those with the strongest household finances.

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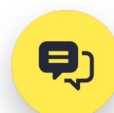


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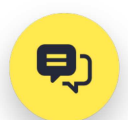
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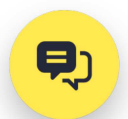
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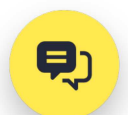
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