WHITEPAPER

PROTECTING LANDLORDS IN A CHANGING MARKET

goodlord

EXECUTIVE SUMMARY

BACKGROUND

UK landlords have had to adapt their behaviour since the resurgence of the private rental sector. But despite an increase in regulation and a reduction in tax relief, the market is continuing to grow and support a diverse range of investors. This paper looks at some of the challenges that different landlords encounter in today's market and reflects on the relevant help, support and advice that is available to protect their investments.

KEY MESSAGES

The ups and downs of the rental property market

The private rental market has grown from 7%[1] to 20%[2] of the total housing market in just three decades. The profile of landlords has also changed, with more experienced investors coming to prominence.

The key motivation for landlords

Most landlords are in the market because they see property as a profitable investment – either as a pension substitute or a continuous source of income.

Protecting empty investments

Empty homes are one of the biggest threats to landlords in today's market.
But specialist insurance policies are helping reduce the risk.

Finding the right tenants

1 in 6 landlords have taken steps to remove problem tenants in the last three years[3]. It is a risk that is being addressed in a number of ways. But new legislation is forcing some investors to re-think their approach.

Keeping insurance options open

While rental risks can be mitigated by the right insurance policies, the number of options in today's market is growing. As a result, financial advisers are becoming much more important.

Understanding landlord responsibilities

With the government looking to safeguard the personal and financial protection of tenants, letting agents and advisers can help landlords to understand their ever-changing responsibilities.

Moving with the times

Not all landlords are aware of the impact that the new tax laws and legislation will have on their business. Professional advice is important to help them adapt and maximise their returns.

Preparing for the future

Regulation has changed the private rental sector and it's important that landlords change too. Letting agents, financial advisers and insurance providers can all help with the transition.

[1] https://www.landlordzone.co.uk/information/landlording-a-history
[2] https://www.pwc.co.uk/assets/pdf/ukeo-section3-housing-market-july-2015.pdf
[3] https://england.shelter.org.uk/__data/assets/pdf_file/0004/1236820/Landlord_survey_18_Feb_publish.pdf

THE UPS AND DOWNS OF THE RENTAL PROPERTY MARKET

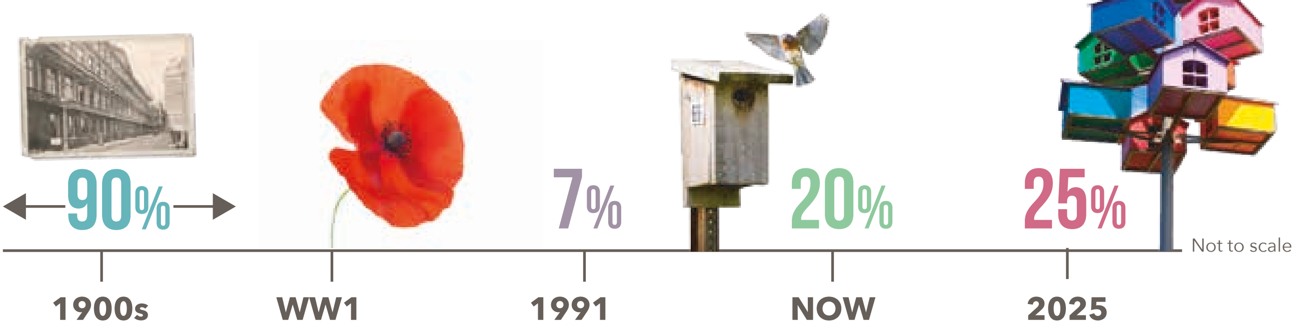
> Only 7% of landlords currently own five properties or more, but these owners account for almost 40% of all rented dwellings[6]

The private rental sector has been growing steadily in the UK since the early 1990s. After hitting an all-time low of 7%[4] in 1991, it is now up to around 20%[5] of the total housing market and expected to reach 25%[4] by 2025. In itself, this is hardly a new phenomenon. In fact, up until the first world war, 90% of all housing in Britain was privately rented. But the growth we've seen over the last few decades represents a significant trend in the modern era that looks set to continue for the foreseeable future. Even against a backdrop of tighter regulation and fewer tax benefits, the market appears to be in very good shape.

What has changed is the profile of landlords. A 2016 survey by the Council of Mortgage Lenders (CML)[6] suggests that new investors are becoming less common. Back in 2004, 18% of landlords bought their first buy-to-let property in the preceding two years, compared to just 7.3% today. The number of landlords over the age of 55 has also gone up from 25% in 2004, to over 60% today. Plus 15% say they expect to sell their properties in the near future with only 9% expected to buy.

This new-found caution may be down to affordability or an overcrowded market. But it seems that the general trend is shifting towards experienced owners and large-scale businesses ahead of speculative investors. To put this into context, only 7% of landlords currently own five properties or more, but these owners account for almost 40% of all rented dwellings[6].

PRIVATE RENTAL MARKET THROUGH THE AGES



[4]https://www.landlordzone.co.uk/information/landlording-a-history
[5]https://www.pwc.co.uk/assets/pdf/ukeo-section3-housing-market-july-2015.pdf
[6]https://www.cml.org.uk/news/cml-research/the-profile-of-uk-private/

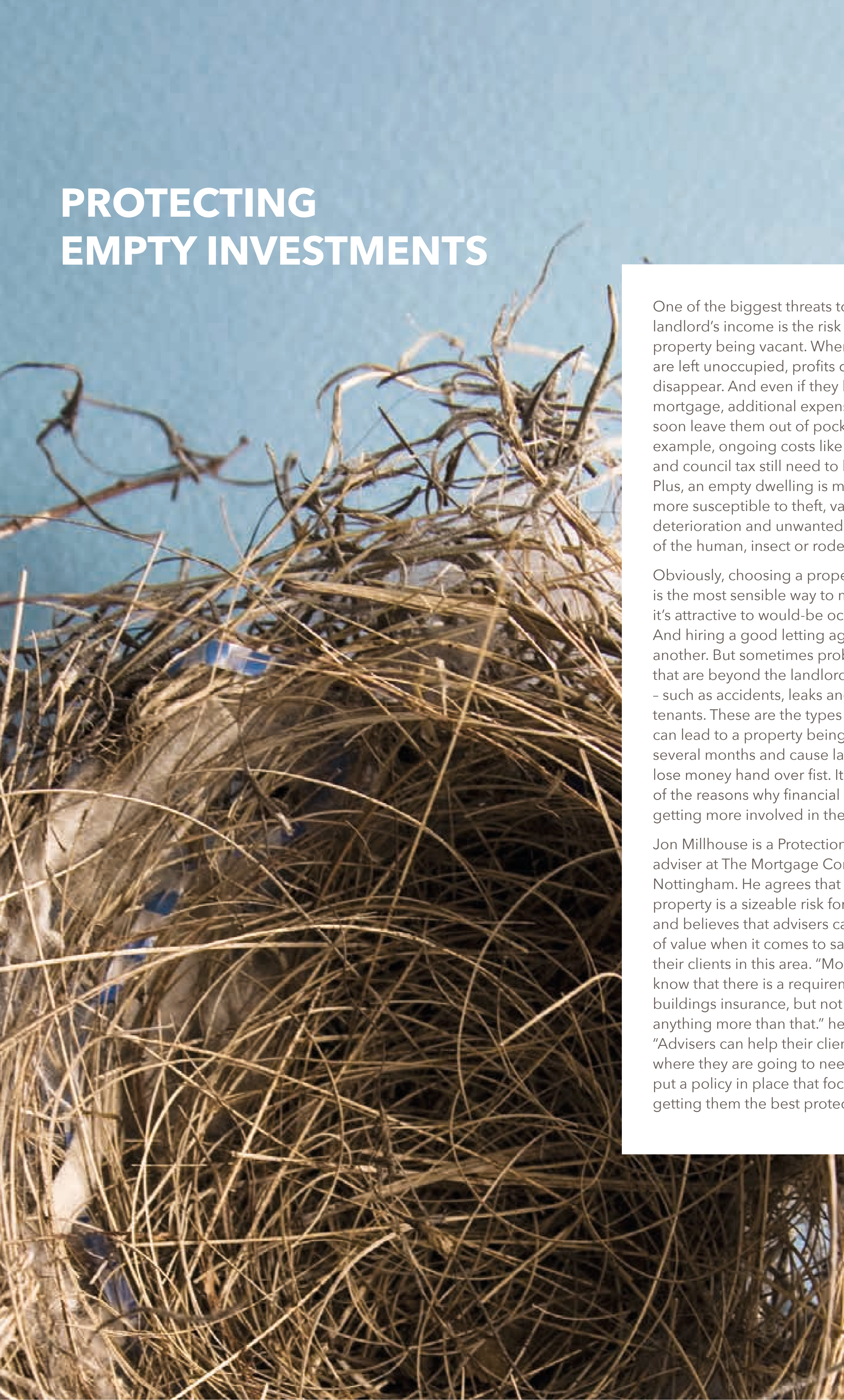
THE KEY MOTIVATION FOR LANDLORDS

Unsurprisingly, the main reason landlords enter the private rental market is that they see it as a good investment. A third consider their holdings as a form of pension, a third are looking for income and capital growth and 27% simply view property as more profitable than any other investments[6]. For some, it's their main source of income; for others it's more of a supplement to their day job. But the ultimate objective is to make money – either now, or in the future.

What's noticeable, is that the risks of being a landlord are much more obvious in today's market than back in the 1990s. There are no longer any assumptions that house prices will continue to soar, that funding will be readily available or that tenants will be easy to find. On the contrary, mortgage lending is stricter than it used to be and the government has added its own complications in the form of stamp duty increases, tax relief reductions and tighter regulation. So, any misguided notions of buy-to-let property being a get rich quick scheme are long since forgotten.

Instead, we have a new reality where modern-day landlords are becoming increasingly aware of the need to protect their investments. 61% are now using professional letting agents rather than taking unnecessary risks themselves. Plus, a growing number are turning to financial advisers to help with everything from tax advice and estate planning to mortgage solutions and property insurance. Arguably, this is something that the industry has been lacking for many years. It's certainly an ideal opportunity for letting agents, advisers and insurance providers to work together and create a more robust framework for their clients.

[7]https://www.landlords.org.uk/news-campaigns/news/sudden-spike-in-use-letting-agents



PROTECTING EMPTY INVESTMENTS

One of the biggest threats to a landlord's income is the risk of a property being vacant. When properties are left unoccupied, profits quickly disappear. And even if they have no mortgage, additional expenses can soon leave them out of pocket. For example, ongoing costs like insurance and council tax still need to be paid. Plus, an empty dwelling is much more susceptible to theft, vandalism, deterioration and unwanted guests – of the human, insect or rodent variety!

Obviously, choosing a property carefully is the most sensible way to make sure it's attractive to would-be occupants. And hiring a good letting agent is another. But sometimes problems arise that are beyond the landlord's control – such as accidents, leaks and problem tenants. These are the types of risk that can lead to a property being empty for several months and cause landlords to lose money hand over fist. It's also one of the reasons why financial advisers are getting more involved in the process.

Jon Millhouse is a Protection and GI adviser at The Mortgage Company in Nottingham. He agrees that an empty property is a sizeable risk for landlords and believes that advisers can add a lot of value when it comes to safeguarding their clients in this area. "Most landlords know that there is a requirement to have buildings insurance, but not necessarily anything more than that." he explains. "Advisers can help their clients pinpoint where they are going to need cover and put a policy in place that focuses on getting them the best protection."

FINDING THE RIGHT TENANTS

Another risk in the private rental market, is the age-old conundrum of finding a suitable tenant. References and credit checks are all well and good, but there are no guarantees. Even candidates that look great on paper can turn out to be far from ideal. And yet if property owners are too picky, they can easily end up without anyone at all.

Regardless of up-front checks, 1 in 6 landlords (16%) have taken steps to remove tenants from their property in the last three years . In 26% of cases this is due to anti-social behaviour or damage to property. But the most common, and arguably most important reason, tends to be late or non-payment of rent - with 46% of landlords acting as a result of rent arrears for over 2 months.

Historically, one of the ways that landlords protect themselves against non-payment, is to take a higher deposit at the start of the tenancy. But the danger here is that it can also price tenants out of the market. Plus, it's not an approach favoured by the government. The 2017 Tenant Fees Bill[9] proposes that rental deposits should be limited to a maximum of six weeks rent.

In today's market, there are plenty of insurance products available that include rent guarantee options to protect properties while vacant. Advisers can help raise awareness of these solutions and encourage landlords to shift their mind-set from 'Which is the cheapest product?' to 'Which product offers the best protection?' It makes a lot of sense and if the advice is taken on board, it may help to keep investors in profit even while their property is empty.

An alternative approach is, of course, to increase the rent. In a 2016 survey[10] 48% of landlords said they put up the rent on their property the last time they set up or renewed a tenancy, with 32% giving the reason that 'the market is going that way'– a statement that presumably includes the need to cover the cost of missed payments.

[8]https://england.shelter.org.uk/__data/assets/pdf_file/0004/1236820/Landlord_survey_18_Feb_publish.pdf
[9] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/656274/Cm_9529_Tenant_Fees_Bill_Web_Accessible.pdf
[10]https://england.shelter.org.uk/__data/assets/pdf_file/0004/1236820/Landlord_survey_18_Feb_publish.pdf

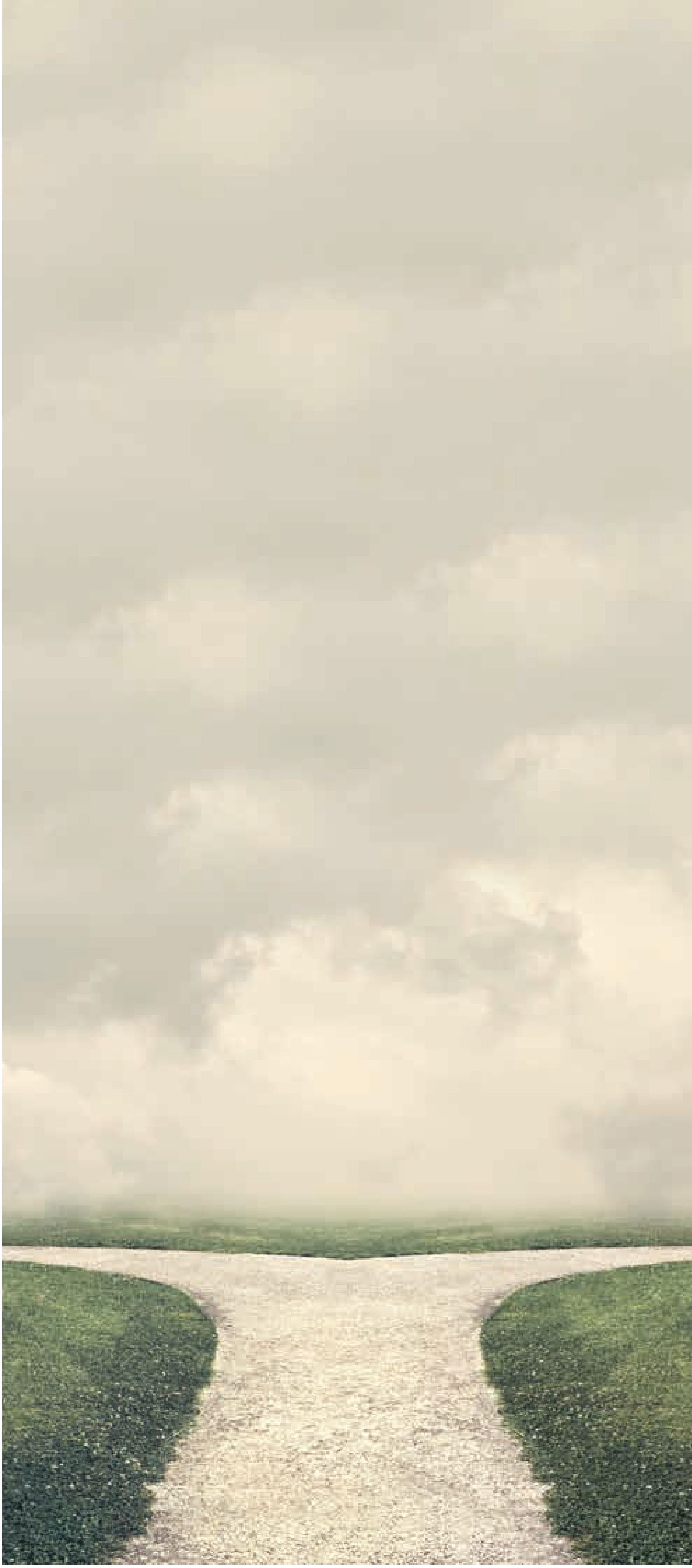
KEEPING INSURANCE OPTIONS OPEN

While some landlords may still be tempted to ask for higher deposits and higher rental payments, in practical terms, there will always be a financial ceiling for tenants. Numbers can only go so high before the forces of supply and demand kick in and it becomes too costly (or measures like the Tenant Fee Bill are introduced). For this reason, savvier landlords are choosing to review their insurance options as a more robust way of protecting themselves against problem tenants.

David Hamblett, a Director of New Wave Financial Services in London, sees the right insurance as an essential solution for modern landlords. He believes that non-payment of rent and tenants who destroy property are the two biggest problems in the current market. And with this in mind, he suggests it's up to advisers to "make sure that landlords are more aware of the risks."

These views are echoed by Graham Wilson, a Director of Options Mortgage Centre in Blackpool. With landlords becoming more experienced, he points out that it's not just the risks that they need to be aware of, but also the solutions. He goes on to say that financial advisers can add a lot of value by explaining to their clients how the different benefits work – especially when it comes to rent guarantee cover, legal protection and malicious damage cover.

In today's vibrant market, products like these are designed to make sure landlords get paid even when tenants don't play ball. There is a wide range of options available, but as always, they vary a great deal in terms of service, benefits and price. That's why landlords need advisers to help them cut through the clutter and find the most appropriate solutions.



UNDERSTANDING LANDLORD RESPONSIBILITIES

In the last few years, there has been a clear statement of intent from the government with regard to protecting tenants in the private sector. Tougher health and safety measures have been proposed for private rental properties, more rent repayment orders have been issued for illegal evictions and greater powers have been given to local authorities to crack down on rogue landlords.[11]

In many ways, these measures are only the tip of the iceberg in terms of where we are heading as an industry. Ross Avis, of AVIS Financial Planning in Newcastle, is not alone in suggesting that 'tougher regulation' represents the biggest change in today's market. And it's hard to dispute the evidence that landlords are now existing in a much more regulated and regimented environment. The industry is certainly under more scrutiny when it comes to having the right equipment, safety certificates and protection in place for private rental properties.[12]

It's easy enough to manage these responsibilities at the beginning of a tenancy, for the simple reason that they can be arranged by the letting agent (as part of a one-off fee). But if landlords are to protect themselves against any ongoing costs that arise mid-term, they may need to consider investing in specialist insurance products, such as landlord emergency cover. Legal protection is another area that is growing in popularity – because with increased responsibilities comes increased liability, which is another potential risk that landlords want to avoid.

These measures are only the tip of the iceberg in terms of where we are heading as an industry.

[11]https://www.gov.uk/government/news/government-supports-new-measures-to-improve-the-safety-of-tenants
[12]https://www.gov.uk/private-renting/your-landlords-safety-responsibilities

MOVING WITH THE TIMES

With lending practices still under the spotlight following the last global recession, it's hardly surprising that the UK government has been monitoring the recent buy-to-let growth with a degree of caution. It also explains why a number of tax changes have been introduced to dissuade anyone other than serious investors from entering the market.

In real terms, the increase in Stamp Duty Land Tax (SDLT), reduction in deductible mortgage interest and removal of wear and tear allowance are already hitting landlords in the pocket (or at least, they will be in the next couple of years). But it's worth noting that it isn't just small-time accidental landlords that are affected by these changes – it's also professional landlords who own multiple properties and are, therefore, more exposed to stamp duty and capital gains tax (which has been retained at 28% and 18% respectively)[13].

As the private rental sector continues to grow, many of these larger investors may have to re-think their strategy, but the majority are comfortable enough to remain in the market. Slightly more vulnerable are the 36% of landlords who currently have buy-to-let mortgages. Although three quarters of them are relatively unworried by the government changes, the other 25% – made up of young, inexperienced landlords or those with just one property – have expressed a concern about the various tax changes . Realistically, these are the people who are most likely to consider leaving the market and would benefit the most from financial advice.

Graham Wilson is one of many advisers who believes that new regulation has created some serious challenges in the private rental sector. He claims that "cascading tax relief is having a negative impact on some landlords and forcing them to offload property." He also suggests that "tax, mortgage and insurance awareness represent a significant knowledge gap for landlords seeking financial advice."

While the evidence for this is a little speculative, the new legislation certainly appears to have gone unnoticed by some of those most affected. Even after the policies were introduced, only 65% of landlords were aware of the stamp duty changes, 52% were aware of the reduction in mortgage interest tax relief and 41% were aware of the wear and tear changes.[14]

Obviously, it's worrying that not all landlords know what they should be paying in tax or indeed what they're entitled to in tax relief. But what's more concerning is that when asked what their first action would be if cash flow deteriorated, the most common answer was 'I don't know'8. Admittedly, this may change as the financial impact starts to make its mark over the next year or two, but for now, it highlights an awareness gap and a genuine need for support.

[13]https://www.cml.org.uk/news/cml-research/the-profile-of-uk-private/

PREPARING FOR THE FUTURE

What we have learnt from the recent changes in regulation, is that affordability and accountability have become high priorities for the government in this market. There is a clear intention to create 'a sustainable high-quality private rented sector dominated by professional landlords with large holdings.'[14]

This doesn't mean that accidental landlords or one-property landlords can't exist within the sector. Quite the opposite – the market is in one of the strongest positions it's been in for years. It's just that smaller investors may need to adapt their behaviours and business models to fit in with a more regulated framework (as indeed will all professional landlords).

In order to minimise their risks, there are those who may want to reduce the number of properties they own, while others may increase their portfolio to make up for a fall in profits. But as a bare minimum, most landlords should be looking to review their rents, deposits and insurance policies to make sure they are suitably protected. Fortunately, there are plenty of solutions out there to make this task easier. Rent guarantee cover, landlord emergency cover and malicious damage cover are just some of the options available in the current market. Plus, new innovations are being introduced all the time.

While this is great news for landlords looking to protect their investments, it also makes the need for help and support that bit more important. What's abundantly clear is that letting agents, financial advisers and insurance companies all have an important role to play in the future of the private rental sector. After all, if the government is looking for more professional landlords, these landlords are going to need professional advice.

[14]https://www.cml.org.uk/news/cml-research/the-profile-of-uk-private/

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