British Property Federation response to the:

BARKER REVIEW OF HOUSING SUPPLY

July 2003

EXECUTIVE SUMMARY

- Up until the 1960s institutions were significant investors in private rented housing. However, the introduction of various rent controls led to a rapid retreat from the sector.
- The introduction of assured shorthold tenancies in the late 1980s has provided the basis for encouraging institutional investment back into private rented housing, but progress has been slow, not helped by the fear that Government can exert too much influence on returns in the sector through change in its tax and regulatory policies.
- Retail investment is an increasingly popular way of investing in the sector and has been buoyed of late by investors' moves away from equities and the increasing 'personalisation' of pension provision.
- Some £25bn has also been invested in the private rented sector (PRS) by buy-to-let (BTL) investors over the last five years.
- Buy-to-let investors will tend to compete for stock with owner-occupiers. With a favourable planning regime, however, institutional investors would commission additional stock.
- An enlarged PRS would help counter some of the volatility in the housing market. Institutions invest in the sector for its income stream as well as capital gains and will thus tend to be longer-term investors, which will help reduce volatility. Unlike owner-occupiers or BTL investors, institutions use less leverage and thus will be able to expand their portfolios when owner occupation is expensive and the private rented sector is in most demand.
- We believe that there is considerable scope for increased institutional and retail investment in the private rented sector. However, if investment is to accelerate it requires a tax transparent investment vehicle, so that investors avoid double taxation and are able to trade units rather than properties.
- There are other tax treatments, which make residential investment less attractive to institutional investors. They will tend to incur the highest rates of stamp duty because their transactions are in bulk and thus incur the highest rate, compared with BTL investors who buy single properties. There are also VAT rules, which favour commercial investment over residential.
- Encouraging institutional investment in the sector would also help serve one of the Government's other key housing objectives, which is to raise standards of management in the private rented sector.
- A particular niche of the market, which institutional investors could provide for, is key worker housing. It could be made attractive to them, with some greater clarity in policy and some relatively inexpensive tax changes, specifically, allowing key worker housing to be exempt from stamp duty and for providers to be allowed to recover VAT on repairs, as Registered Social Landlords do now.

- Greater institutional investment in key worker housing would also require planning policy changes. To make it financially viable key worker housing would need to count towards a developers' section 106 obligations. There would also need to be greater certainty on what is and what is not a key worker. To ensure that institutional investors are not competing with owner-occupiers and BTL investors for stock we would also recommend that the Government considers introducing a new use class - key worker housing for rent.

- Like all property owners, institutional investors are affected by other supply factors, such as construction capacity and planning policy. The problems with the latter are as much about how the system is applied at a local level as the system itself, specifically; resource issues, the lack of certainty in the process (which equally applies to planning obligations), time it takes, absence of prioritisation in some local authorities, and a mindset that only RSLs can manage good quality affordable housing.

INTRODUCTION

1.1 The BPF welcomes the opportunity to respond to this Review. We have considered how best we could add value and decided that our members' perspective as long-term investors and managers of funds in the housing sector is something that we should explain. We will therefore concentrate on issue 4 of the Review consultation paper, which focuses on the private rented sector, although inevitably that will mean covering some of the planning and construction issues encompassed in issues 1, 2 and 3.

1.2 We are particularly keen to illustrate the important part that the private rented sector plays in providing greater stability in the housing market; how that role can be enhanced by encouraging institutional investment in the sector; and the contribution the industry can make to providing more key worker housing.

The Industry

1.3 A difficulty we find is that our industry is not well understood by policymakers or indeed the wider world. We thought it might therefore be helpful first to define who are the main participants in our "industry" and their motivations:

- **Housebuilders** – Their primary objectives are land assembly, gaining planning approval, construction and unit sales. Housebuilders are predominantly trading companies; few have sufficient equity to retain portfolios of PRS or affordable housing portfolios on balance sheet, nor the experience to manage them.

- **Registered Social Landlords** – RSLs have a clear objective to provide for those in need of social or affordable housing. Government provides primary funding for RSLs' expenditure on property acquisition and maintenance, but these amounts are dependent on geographical requirements, the health of the UK economy and land supply constraints. A number of RSL's have some PRS knowledge, but cannot grow this without funding, which is difficult for them to raise both because of existing high levels of borrowing. Few are organised to manage PRS stock, in which tenants have different priorities, or are organised to be as efficient as the private sector.

- **Corporate investors** – A large number of small private companies invest in the sector, concentrating on regulated and assured tenancies, as well as assured shortholds. However, many private companies are unwilling to raise external capital and therefore increased investment in the sector is dependent on increasing levels of debt, and more active trading of assets. A small number of publicly quoted UK companies invest in the PRS, though most trade at a discount to net asset value (NAV), and the absence of a tax efficient property vehicle, active in the US, Australia and parts of Europe, has limited an increase in corporate investment in the sector.

- **Individual direct investors** - There has been a substantial increase in individual investment in the PRS, created largely by the ability of BTL investors to access cheap finance. It also reflects the decline in returns coming from other investment markets and the fact that owner-occupiers have some knowledge of the sector. Questions remain whether these BTL investors, many of whom depend on a substantial amount of debt to finance their purchases, are really long-term investors in the sector.

- **Individual indirect investors –** Though small, this is a quickly growing sector, with some organisations providing retail investors with products, often with a specific sub sector or focus.

- **Individual overseas investment** – This largely reflects overseas High Net Worth investors desire to own a property/properties mainly in London, as well as in the surrounding counties. One major global wealth manager reported that some 80% of their clients had one or more properties in London, but this market is highly responsive to changes in Capital Gains Tax policy.

- **Institutional investment** – Domestic and overseas institutional investment in the PRS is both small in proportion to their other property assets and to the recent investment made by BTL investors in the sector. However, in recent years there has been an increase in these institutions investing indirectly in the PRS. Whilst the UK is unlikely to see substantive growth to the levels seen with our European neighbours, there is a strong school of thought to suggest that institutional investment could grow to between 2%-5% of all property holdings. In financial terms, this would represent between £2.5-£5.5 billion. However a number of factors continue to inhibit a substantial increase in investment in the sector. (See Appendix A)

CONSTRAINTS ON THE SECTOR

2.1 Comments in the Review paper suggest that institutional investors have not typically invested in the sector, yet eighty years ago some 10% of the housing sector was owner-occupied and the remainder rented property. The UK insurance companies were large investors in newly built housing to rent from the late 1920s until the early 1960s (see Appendix B).

2.2 Government intervention in the 1960's/1970's, particularly in changing lease terms, led to these investors ending their direct investment in the sector, yet recently there has been increased interest in the sector.

Why has there been no expansion of housing for rent?

2.3 FPD Savills estimate that £2bn a year of investment in the private rented sector will be needed over the next two decades to cater for expected demand.[1]

2.4 Recent Government housing policies have largely concentrated on trying to:

1. Increase the supply of brownfield sites and the densities on housing developments.
2. Use Section 106 agreements to finance social housing requirements.
3. Reduce the tax advantages of home ownership.
4. Support the creation of a high quality PRS, by simplifying occupational leases and focusing on standards.

2.5 However, demand continues to outstrip supply and recently House Price Inflation (HPI) has grown at an unsustainable pace.

2.6 One factor that Government has not actively encouraged is an increase in the size of the UK PRS to other European countries' levels.

2.7 Government may argue that by making no further changes to assured shorthold tenancy agreements it has effectively opened the way to a larger and more efficient PRS and that this is now being reflected in the increase in recent BTL investment. However, the BPF considers that this increased investment by individuals may itself be a material factor behind the recent growth in HPI, may not be long-term in nature and may lead to further problems in the future.

Increased investment in the PRS from individual investors

2.8 ARLA and the CML report that some £25bn has been invested by individuals in the PRS, purchasing some 230,000 properties over the last four years. The growth in UK HPI is a reflection of a number of factors including continued low levels of supply, the health of the economy and lower nominal interest rates, but new investor demand may also have been a major factor in stoking HPI growth.

2.9 Whilst many BTL investors have experienced considerable capital growth in their investments, there is a growing risk that individual investors may not be sufficiently experienced to understand the full demands of PRS properties, in particular:

- Many have not budgeted for higher repair and maintenance costs in the future. The Association of Residential Letting Agents (ARLA) reports that 50% of BTL investors stop using an ARLA agent after the third year, adding to the concern that individual investors lose interest in maintaining high standards.

[1] Private Renting: A New Settlement - A commission on standards and supply, Shelter/Joseph Rowntree Foundation, 2002.

- There are signs that falling rents, increasing voids at the higher end of the market, and the high costs of city centre properties has led to a substantial reduction in returns, and to lower BTL activity in the last few months.

- This reduction in activity whilst initially helping to limit the growth in HPI, may in time lead to many of these investors exiting from the PRS, potentially adding to more price volatility.

- Institutional demand for BTL properties is low, and it is therefore likely that most properties will be sold to owner-occupiers, leading to a reduction in the PRS.

- Any substantial reduction in the PRS could lead to a reduction in labour market flexibility and would lead to higher rents.

2.10 We believe that Government should give serious consideration to whether HPI growth might have been substantially lower and less volatile if these individual investments had been channelled through indirect investment vehicles. More generally, Government should consider the impact that individual investment will have on the sector:

- **Individual buying power** – Individual investors have limited buying power when dealing with house builders and many have been attracted to newer more expensive properties.

- **Knowledge and experience** – Individual investors may have experience as owner-occupiers, but like most car owners that does not make them experts on maintenance issues, pricing, or safety. Owner-occupiers' knowledge of the housing sector should not be confused with PRS experience and management skills.

- **PRS demand for higher density housing** – PRS demand is greatest for higher density two bedroom flats and houses, with rental levels below £800 pm. Many individual buyers have been persuaded to invest in new city centres developments, where higher rental levels are required to meet interest and other costs.

- **Leverage** – Many individual investors use high levels of leverage to purchase their BTL properties, adding further volatility to the housing sector, if interest rates were to rise. The CML reports that the average BTL loan to value is 80%.

- **Maintenance of high standards** – Many individual investors have little experience of the PRS and many will not have budgeted for future repair and maintenance costs, particularly as properties age. The CML report that gross rental income/interest cover is only 130%.

Institutional demand for rented accommodation investments

2.11 Institutional demand for rented accommodation assets have had a number of hurdles to surmount in recent years:

- Institutions are concerned that there is risk of a change in Government policy that may limit the returns and, or liquidity in the sector. A long-term and proactive strategy for the Private Rented Sector, which Government does not have at present, may help allay any lingering fears.

- The Government's use of Stamp Duty has been a very blunt way of containing rising HPI. Whilst an attractive revenue opportunity, it increases institutions' costs, makes investment opportunities more marginal and leads to lower liquidity for portfolio sales.

- Net yields on residential assets are low in comparison to other property classes, due to a combination of rapidly rising prices, stable or falling rents and high purchase costs. Institutional investors prefer to see a mixture of income and capital returns, but the Government's substantial increase in Stamp Duty over the last three years has added to the bulk purchase costs of properties, helping to further reduce the yield and helped make the sector less attractive. Effectively, the charge to an institutional landlord will be an additional 3% compared to an individual buy to let investor. The knock-on effect on an average valued unit, is to reduce net income by around 0.2-0.3%. (See Annex E)

- Few institutional investors wish to directly own PRS properties, which leads them to consider in-direct investment vehicles. These vehicles have been created to cope with demand and they do provide tax transparency, but as currently constituted, they lack liquidity and limit the investor base. Stamp duty is currently paid on total portfolio acquisition cost, not at the rate of the average or individual property value, which will almost always be much lower.

- Investors in commercial property are used to long-term full repairing institutional leases, yet the PRS provides much shorter and flexible tenancy agreements and tenants are more demanding as to levels of service and their day-to-day requirements. Good management of PRS properties has been an issue for some time, as the housing market has often been accused of and suffered from low levels of training. However, in the last seven years a number of residential fund managers have been successful in proving to institutions and investors that they have the financial skills and the high standards, to reduce these investors' reputation risks and provide them with acceptable returns.

- Institutional investors need to compare their PRS investment performance against some sort of benchmark and the enormous variation of different housing indices, available from Government and from mortgage lenders, has been a major concern. The IPD Residential Index is going some way to meet investors concerns, though further improvements in the Index will be an important influence on increased institutional investment.

2.12 Institutional investment in the PRS has slowly increased (again see Appendix A), but investors continue to be concerned that there remain a number of issues, some for Government to resolve, which could lead to a substantial increase in the long-term attractiveness of the sector.

ENCOURAGING INSTITUTIONAL INVESTMENT IN THE PRIVATE RENTED SECTOR

3.1 As explained, the Government has benefited from a considerable investment in the PRS from individual investors in recent years, but probably at the cost of increased growth in HPI. Greater institutional investment, including indirect retail investment, would help provide a more balanced sector and housing market in general.

3.2 However, if the Government wishes to encourage long-term investment in the PRS and Key Worker sector, it needs to address the lack of a suitable vehicle. There have been attempts in the past to remedy this, for example, Housing Investment Trusts. However, they were stillborn, as the Government of the time had little understanding of the PRS and did nothing to understand the needs and requirements of long-term investors in the sector.

3.3 **The absence of tax efficient residential investment vehicles is in our opinion the biggest single barrier to the future expansion of institutional investment in the PRS, or indeed the funding of Key Worker accommodation.**

3.4 A vehicle that meets the needs of long-term institutional and individual investors would have a number of compelling advantages for Government:

- Vehicles would encourage developers/house builders to build new stock, or compete for land/brownfield sites.
- Vehicles would use their buying power to secure considerable discounts from developers/house builders, reducing the opportunity for growth in HPI.
- Vehicles would also use their buying power to ensure that house builders met high standards and moved to modern lower cost construction techniques.
- Vehicles would be co-investors in mixed-use sites, allowing developers to compete with house builders for the residential portion of developments, and bring forward more marginal schemes.
- Investment managers recognise strong tenant demand for two bedroom units in urban locations and would encourage house builders to meet this demand.
- Experienced PRS fund managers budget for increased repair and maintenance costs and will have the buying power with suppliers, to lower these costs.
- PRS investment vehicles are likely to have low levels of leverage, making them less at risk from moves in interest rates.
- Investors in a large quoted investment vehicle would have greater liquidity and if they wish to exit need only to sell all, or part of a shareholding, rather than properties.
- Such funds would be considered less risky for investors, due to their wide geographical spread of properties, their higher income returns and experienced management.
- A fund (dependent on structure) will not be under pressure to sell its property assets, if individual investors sell shares, leading to no decrease in the number of PRS units.

3.5 In addition, residential property is considered an ideal asset by pensions funds, providing there is a suitable vehicle to encourage this investment. The combination of reasonable income yield and prospective capital growth are the ideal characteristics for pension fund investment. This would help to boost pension funds as well as increasing investment in housing.

3.6 To give a kick-start to such vehicles we would also advocate that Government considers:

- Bulk purchases of units or portfolios by a vehicle should be at the Stamp Duty rate applicable to the average price, rather than the combined price.

- The vehicle would be able to recover VAT on repair and maintenance costs, thereby encouraging high standards and putting them on level playing field with commercial properties.
- Individual investors should be able to invest both their SIPPs and ISAs in the vehicle, in a similar way to individual investors who invest in commercial property vehicles.
- The vehicles should be tax transparent, with tax being paid at the investor level. The assumption would be that 85% of corporate revenue, after tax and depreciation, would be distributed annually to shareholders.

SUPPLY CONSTRAINTS

4.1 We see increased institutional investment leading to a more balanced housing sector in the long-term. In the short-term, clearly institutions will suffer the same supply-side constraints as owner-occupiers or BTL investors.

4.2 House builders and the construction sector are better placed to explain any capacity constraints in the building sector. With regards to finance, house builders are highly profitable and able to generate significant cashflow to fund developments as a stage-by-stage process. However, they are not awash with development finance and we believe would struggle to increase capacity to the levels of supply the Government desires or some areas need. What institutional and retail investment would offer is large amounts of development finance, which could commission projects with the finance available up-front, rather than having to rely on generating development finance from the profits on a housing scheme a stage at a time. In addition, institutional investors have access to the greater resources of commercial property companies, which extend beyond the pool of resource within the existing house-building sector.

4.3 The other main constraint identified in issues 1, 2 and 3 of the consultation process is the planning system. We have been a very active lobbyist on the planning bill and enclose some of our main points on that as an appendix (see Appendix D).

4.4 However, for the benefit of this Review we thought it might be helpful to look at the planning system in its broadest sense and also with reference to housing, the increasing use of planning obligations by local authorities.

4.5 Like any business making an investment decision what institutions investing in housing seek is some degree of certainty. Clearly, planning decisions involve a democratic process and there will never be 100 per cent certainty about the outcome. Developers accept this and do not see it as a significant barrier to an effective planning system, but what is unacceptable is lack of certainty and clarity as to the process and time it takes to reach a decision in local authorities.

4.6 Part of the problem is resource, which manifests itself in different ways. Firstly, Planning Officers' package of remuneration in local authorities does not compete with what is available in the private sector. Secondly, there are also too few Planning Officers, necessitating considerable use of consultants during peak times. Increasingly, many of the best Planning Officers being tempted away to the private sector.

4.7 There is also a skills issue, particularly with respect to the assessment of planning obligations. Local authority officers simply don't have the skills to be able to assess what is a reasonable and unreasonable planning obligation based on need arising from development. To do so requires a good appreciation of amenity capacities and the risk and returns that are acceptable to the private sector - an appreciation which can only be built up through significant training, or experience of the private sector. Without such knowledge there is a danger that officers will under-estimate planning obligations, selling the local amenities short, or worse still, over-estimate the planning obligations which can be sought, preventing a whole development taking place.

4.8 The lack of clarity and certainty over the process and time expended is a risk for developers, which is reflected in the returns they seek. When the additional costs of developing brownfield land are added in, costs of utility connection and the other planning obligations that local authorities seek, for everything from transport to public space, it can tip the balance against development, particularly where the project was marginal to start with. This is increasingly being seen in London where the levels of affordable housing sought are such that an increasing number of private developers and investors are now developing elsewhere, resulting in less housing, regardless of form.

4.9 Fundamentally, however, the biggest complaint of our members is the lack of prioritisation and co-ordination within local government. It is often apparent that there has been little dialogue between different parts of the same local authority, with the housing department, planning, transport, etc., all working in their own silos. To be fair, not all local authorities should be tarred with this brush. Some do communicate across functions and indicate their priorities with a hierarchy of needs in their local plans, but many do not, leading to a feeding frenzy, with each part of the council keen to extract their needs from the planning obligations placed on a developer.

4.10 A distortion to the supply of available land which members often come across is the reserving of land by local authorities for employment use. Whilst we appreciate that sustainable communities need a source of employment, the reserving of land in this way often appears to have been driven more by political dogma than based on an assessment of the facts, for example, research into the likelihood of commercial occupation, the proximity of jobs in neighbouring boroughs or need for employees to commute into those areas, and the quality of transport links.

4.11 Finally, a specific planning issue which dissuades institutional investment in the sector is the presumption that only RSLs can manage affordable and key worker housing. If institutions are to be encouraged to invest in the sector they will want to exert a degree of management control over their assets. However, most affordable and key worker housing provided through planning obligation comes with the condition that it must be managed by an RSL, and it is not uncommon for the local authority to even state the specific RSL that must be used.

KEY WORKER HOUSING

5.1 The Government has at various junctures tried to encourage private sector money into 'public sector' accommodation. For example, it had success in 1995/96 by introducing private sector finance to fund the MoD's housing estate and has continued to attract investment in MoD housing through PFI contracts. The provision of student accommodation has also attracted a variety of investors, as voids are low, demand is constant, and the planning system has been sympathetic. In addition, it provides a low risk for investors as the leases are with universities and the management handled elsewhere. However, recent increases in students' education costs and growing questions over the value of some degree courses, may lead investors to reconsider the future viability of the sector. The private sector has, however, also had some poor experiences of investing in accommodation with a social motive; for example, in the provision of private Care Homes, where revenues were largely controlled and then reduced by Local Government, at a time when Central Government increased costs, of staff, through the introduction of the Minimum Wage, new building requirements and increased training levels.

5.2 Specific Government actions have done little to attract the private sector to invest in social housing sector and the Housing Corporation's unwillingness to encourage private sector managers to compete with RSL's, has combined to limit investors' interest.

5.3 However, there is considerable interest from institutional and private investors to help fund the Government's need for Key Worker housing, and the BPF recently presented a paper to the ODPM on this subject (Appendix C). As Key Workers' salaries increase, they move on to being tenants in the PRS and thereafter to owner-occupation. Many institutional investors therefore see the purchase and management of Key Worker housing as a natural extension of their own investment in the PRS, allowing them to purchase a mixture of tenancies on the same site.

5.4 If the Government wishes to encourage private sector funding for Key Worker housing it will need to provide the vehicle and tax changes we suggest in section 3. In addition, however, to ensure that planners provide sufficient supply we recommend that Government should create a distinct key worker housing for rent use-class.

5.5 To ensure that returns from key worker housing are attractive to institutional investors there would also have to be some element of public subsidy (not necessarily grant), which could take one or more of the following forms:

- The Government is already considering paying grant to house builders to supply social or Key Worker housing. A long-term vehicle could work with house builders to provide the long-term ownership and management, but would require changes to the Housing Corporation's rules.
- RSL's purchase of Social or Key Worker housing is Stamp Duty exempt. To create a level playing field purchases by a vehicle of Key Worker housing should also be exempt.
- Planning policy could be used to provide subsidy, for example, allowing greater density than is normal, although that would raise construction and management issues.
- Public sector land could be made available at discount, although that would require changes to 'best value' policy.

5.6 In deciding whether to invest institutions will also require greater clarity in planning policy. For example, would key-worker housing count as part of a local authority's assessment of planning obligations (even if time limited to say 15 or 25 years) and for the purposes of this and other reliefs greater clarity is needed on who is a key worker, or at least the process of deciding that at a local level.

CONCLUSION

6.1 The current mismatch in supply and demand for housing in some areas is not going to remedied overnight. However, we believe that the expansion of the PRS through institutional investment provides an excellent opportunity to encourage a more balanced housing sector in the long-term.

6.2 What we would recommend the Government considers is how it can encourage long-term investors into the sector? In particular we have set out the desperate need for an investment vehicle and the benefits that would flow if such existed.

6.3 There could also be a considerable synergy of interests between institutions' desire for steady income and good tenants, and the Government's need to increase the supply of Key Worker housing. With some relatively inexpensive changes to tax policy and a clearer steer from planning policy, plus the correct vehicle, significant sums of institutional investment in key worker housing could become a relatively quick-win reality.

APPENDIX A

Institutional investors in the residential sector

- Electra Fund Managers
- Barclays Pension Funds
- BP Pension Fund
- Clerical Medical and General Insurance Company
- Clients of:
  - Aberdeen Property Investors
  - Citigroup Private Client Management
  - Grosvenor
  - ING Real Estate
  - LaSalle Investment Management
  - Merrill Lynch Investment Management
  - Morley Fund Management
  - Nomura Bank
  - Schroders Investment Management
- HSBC Special Investments
- ING Real Estate
- IBUS Fund Managers
- Prudential Fund Management
- The Coal Miners' Superannuation Schemes
- Wellcome Trust

Residential Fund Managers (investing institutional funds)

- Aberdeen Property Investors
- Allsop Residential Investment Management
- Fairbridge Residential Investment Management Company Limited
- Grainger Trust
- Grosvenor
- HSBC Special Investments
- ING Real Estate
- Morley Fund Managers
- Teesland Investment Management

APPENDIX B

Institutions who originally owned flats that now belong to Grainger Trust and Bradford Property Trust include:

Norwich Union
Prudential
Sun Life
Sun Alliance
Liverpool Victoria
Friends Provident
Legal and General

APPENDIX C

A BPF Discussion Paper

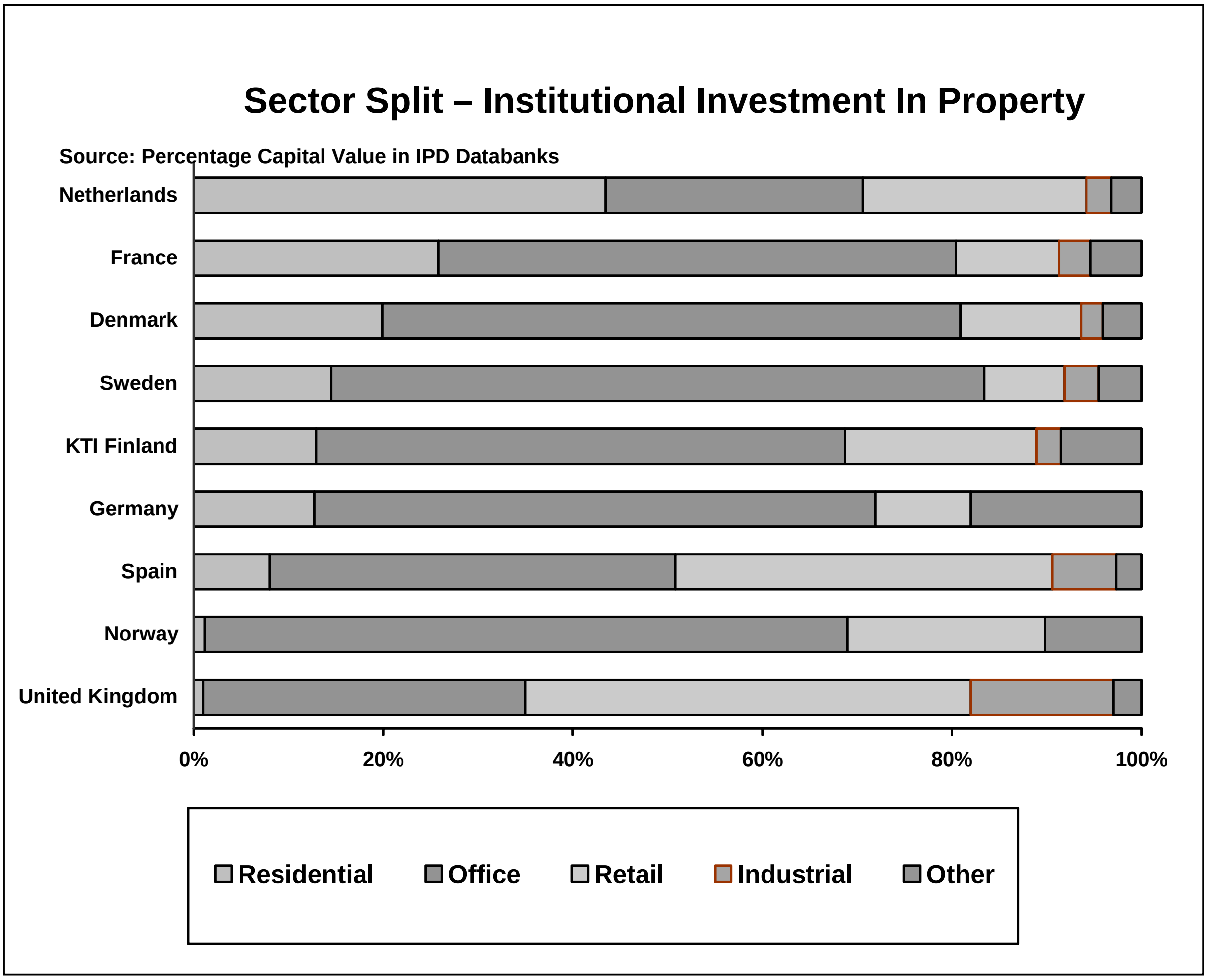
Encouraging Investment in Key Worker Accommodation

June 2003

Introduction:

Tackling the shortage of Key Worker housing in London and the South East is high on many organisations' agendas. We believe that the private rented sector, with appropriate policies, could provide a solution.

As the chart below illustrates, there is huge potential to increase institutional investment in residential property in the UK. Institutional investors, however, whether they are from the UK or overseas, and representing pensioners or retail investors, ultimately have a duty for any level of risk to maximise returns. There is no fundamental barrier why key worker housing cannot deliver such returns. However, it will require greater creativity and clarity than current policies are offering.



There are a number of factors and conditions that will either attract or deter investors from investing in key worker housing, such as the type of investment vehicle, the availability of the key worker housing and type of tenancy. This paper seeks to outline some of these key issues, and suggest options for attracting investment into Key Worker housing in the private rented sector.

1. Initial yield

Commercial and residential property has attracted considerable investment in the last three years, partly as a response to falling equity markets and partly due to higher yields than on equities or bonds.

If Key Worker accommodation is to attract substantial investment it will have to compete with returns from other residential and commercial property investments.

2. Type of investment vehicle

Institutional investors prefer to invest in residential assets through indirect vehicles, either unauthorised unit trusts based offshore, or a UK Limited Partnership. To mitigate set up costs these vehicles need to be sizeable, with minimum amounts of £100m, and unit trusts need to be able to meet investors liquidity requirements.

Retail investors prefer to invest through a company structure, as many did in Business Expansion Scheme (BES) companies. An open-ended structure such as a unit trust might be unsuitable for investment in long-term illiquid assets.

Listed vehicles might attract retail investors, but would be unlikely to attract pension fund investment, because of their tax treatment. Fund raising is also expensive using a listed vehicle and historically most have traded at a discount to Net Asset Value (NAV).

Retail investors will expect to invest for normally about five years, institutional investors for longer periods. We believe that retail investors should be encouraged to think longer term by allowing them the option of investing through their pension plans.

3. Taxation

Thinking through some of the tax issues, investors in Key Worker residential investment vehicles might be encouraged through the following, in respect of their tax status:

- No Stamp Duty to be payable on purchase, as in other Section 106 agreements.
- Recovery of VAT on repairs and maintenance.
- Individual investors will be able to invest their ISAs and SIPPs in residential investment property, including Key Worker investment vehicles.

Subject to the rental yields, the clarification of Key Worker tenancies and the cost of purchasing units, Key Worker residential investment vehicles could attract substantial investor support.

4. Investment Manager's Track Record

It is likely that investors, particularly institutional investors, will expect their investment vehicle managers to have extensive experience of both the private rented sector and of managing indirect investment vehicles. Few institutional investors will invest if Registered Social Landlords are required to be the vehicle managers, although that is not to preclude them as one option.

5. The availability of Key Worker housing and the type of tenancy

To make Key Worker accommodation attractive to institutional investors it will need, at least initially until the sector matures, to be part of a Section 106 agreement, replacing the need for social housing on a wide range of new developments in areas of the greatest need, such as London and the South of England. However, with local planning delays, limited site availability and very few properties being built currently, there is a risk that investors will become disenchanted if unable to invest in Key Worker homes, or blocks of flats.

Central government will need to give local planning committees clear guidelines to provide Key Worker housing in designated areas, in many cases in preference to social housing requirements (see case study). It will not be sufficient for them to be considered as an optional bolt on to traditional social housing. In a bid to ensure that some housing provision is targeted at Key Workers one option would be to create a new residential use class, which would have specific restrictions to encourage investors. A new use class (C4), within the residential classification, but separate from the existing C3 (a dwelling house), could be established.

The definition of a Key Worker tenancy is clearly very important to investors and Government will need to clarify:

- The definition of a Key Worker, which would need to be sufficiently broad to ensure good long-term demand for the accommodation.
- The major conditions of a Key Worker tenancy, such as who is the tenant?
- How Key Worker rents should be set, and on what basis they should be reviewed?

Conclusion

There could be significant demand from investors for residential accommodation, as it seen as a potential source of long-term stable income. However, this investment is currently deterred by a number of perceived risks, which this paper has sought to highlight. Such barriers that exist could be overcome if the appropriate incentives are offered through the tax and planning systems. We would be willing to put forward members to a joint working party to discuss these and agree concrete proposals.

Case Study

Laing Homes' affordable housing proposal meets with approval at planning appeal

Planning Appeal decision APP/B1930/A/01/1073344 (13 March 2002)

Laing Homes obtained Planning Permission for 55 houses at St Albans, Hertfordshire. 6 units were to be "affordable housing" in accordance with a scheme to be agreed with the Council. The Council failed to reach a decision on details submitted by Laing and Laing appealed on the basis of a deemed refusal. Laing's proposals were directed at key workers such as teachers, police officers, etc. and proposed the freehold sale of the 6 units to a housing association at 60% of open market value. The housing association would liaise with local employers and let the units to key workers at affordable rent levels.

The Reporter dealt with the three key issues raised by the Council:-

- Prioritisation

  As the scheme would be restricted to key workers, the Council argued that it would not secure affordable housing for those in greatest (priority) need. The Reporter agreed, but the thrust of local and national policy guidance is that the Council should aim to meet a wide range of housing needs. The needs of key workers were not being addressed in the district. The Reporter decided that the scheme would make a modest contribution to meeting the housing needs of key workers and it would not conflict with the Local Plan.

- Permanence

  The housing association would purchase the properties on the basis of a 20-year commercial loan. After 20 years, the homes would either be offered for sale at a discount or the debt re-financed and continue to be rented. The Reporter noted that tenants' rights to purchase limited the weight that can be attached to the local plan review policy in respect of making units permanently available. The Reporter thought there was a reasonable prospect of the units being retained for affordable housing for a longer period in the hands of a Registered Social Landlord. The conclusion was that the scheme would offer benefits to the Council for a substantial period of 20 years.

- Enforceability

  The Council were concerned that if the scheme rested on a planning condition rather than a planning obligation under the equivalent of a Section 75 Agreement, the discount price may be altered, the rents may be increased or the definition of key workers may be altered. The Reporter rejected the objection stating that the difficulties of enforcement were not well founded as the scheme would be run by a Registered Social Landlord.

The Reporter approved the scheme submitted by Laing stating that it would meet the needs of key workers whose salaries are insufficient to enable them to purchase or rent homes and that it would satisfy national planning policies for affordable housing and contribute to meeting the needs for affordable housing in the district.

APPENDIX D

PLANNING AND COMPULSORY PURCHASE BILL – SUMMARY POSITION

More than most, the property industry needs an effective planning system. Like every business sector, organisation and individual it has an interest in how areas evolve and hence a direct stake in planning. Beyond that, it largely depends for its performance on the performance of the planning system. In turn the nation relies on the property industry to provide the quantity and quality of buildings and environments we need.

In return, what the property industry needs from the planning system is clarity, consistency and certainty. These can be described as the three tenets for those contemplating investing in the intrinsically risky activity of regeneration. The delivery of these qualities will provide the confidence and surety necessary for more regeneration projects to come forward more quickly.

Following these principles, we are gravely concerned by the proposal, which appears in the Bill, to eventually abolish outline planning permissions and replace these with comparatively woolly statements of development principle. The latter mechanism provides no certainty that providing the developer meets a range of conditions with the application, that planning permission will ultimately be received. It is therefore of no interest to financiers who would not be prepared to fund the enormous start up costs of regeneration schemes on the basis of these statements.

In some areas of the Bill we are concerned that speed is being pursued at the expense of one or more of the three tenets. For the commercial property industry it is not all about speed. For instance punitive targets for assessing applications for development, (brought forward in the pursuit of speed), could lead to some local authorities simply declining applications in order to meet their target for decisions taken. We agree that local authorities should be measured on their planning performance but primarily on qualitative rather than quantitative terms and not before properly addressing resource issues.

Similarly the origin of the Government's proposal to reduce the normal life of a planning permission from five to three years is the pursuit of speed. But again such a policy, certainly for major schemes, is misplaced. Developers and those that finance development require the certainty of a permission that extends to the likely time needed to develop a scheme. HSBC's European Head of Real Estate and Construction has confirmed that he would not be prepared to finance the significant start up costs associated with major projects on the basis of statements of development principle.

Finally, Local Development Orders contained in the Bill are warmly welcomed by the property industry, but again the proposal that a local authority could quickly rescind these without any notice period at all is another example of where certainty would be destroyed through misplaced pursuit of speed.

1. PROPOSAL TO ABOLISH OUTLINE PLANNING PERMISSION AND TO REPLACE WITH STATEMENT OF DEVELOPMENT PRINCIPLES

There is no reason to do away with outline planning permissions. When used properly, with the imposition of condition(s), they ensure the integrity of the final scheme. A statement of development principles is fundamentally different to outline consent, as it grants no permission, merely a material consideration when a similar application is made within the next three years. It lacks sufficient certainty for investors contemplating complex schemes and would dissuade development proposals from coming forward.

Outline planning permissions are a crucial tool in any major development proposal, since a developer wishes to establish definitively the principle of the development in question without having to spend time and money in working up fully detailed proposals. The grant of the outline permission does constitute the planning permission which permits the carrying out of the development even though the developer is still required to obtain approval for the various reserved matters. Revocation of an outline planning permission entitles the developer to substantial compensation. A condition precedent to many funding arrangements will be the grant of outline planning permission since it is known that appropriately formulated details of the reserved matter will result in their being approved.

We understand that most Local Planning Authorities (LPAs) are equally anxious that outline permissions are retained. Moreover the Local Government Association is understood to be tabling an amendment to retain outline permissions and to delete clauses referring to Statements of Development principles.

2. PROPOSAL TO REDUCE NORMAL DURATION OF PERMISSIONS AND CONSENTS FROM FIVE TO THREE YEARS

Currently a development must begin within five years of a planning permission being granted unless otherwise directed by the local authority. In practice, this has resulted in the vast majority of permissions, regardless of the type or scale of development, being granted for five years. We are seriously concerned that by changing reference to the normal life of a permission from five to three years, (apparently to address concerns over the speed at which housing permissions are being implemented), that a great many schemes that would reasonably require longer to take forward will be required to go through the process of seeking an extension.

This would result in uncertainty and increased bureaucracy and would dissuade developers and investors from committing to complex schemes. Whilst five years may appear to be a generous period of time in which to take forward a planning permission, in reality, for major schemes, there are typically many issues outside a developer's control, such as consents from Agencies, that can delay the process and prevent development from commencing until resolved.

We do not accept that the existence of an unimplemented permission prevents the use of potentially developable land for other purposes. There may be many reasons why a permission is not immediately implemented, including finance or a lack of end-user demand. If another purpose is suggested, the existence of the existing permission will not serve to inhibit the planning process being taken forward for that new purpose.

Landowners and developers must enjoy some certainty that a permission will endure for a reasonable time, given the potentially long lead-in times associated with major developments. Site assembly may well have to be undertaken. Although it is clearly not possible to identify a particular length of time as being necessary or correct, we are not persuaded that there is any justification for reducing the five year period to three years.

It is appreciated that, as with the 1990 Act, the new proposals would allow the LPA to prescribe a longer or shorter period than the statutory five year or three year period. The fact remains, however, that, other than in the case of large developments, LPAs almost invariably follow the statutory model and impose a five year limit. If the Act is amended, LPAs will undoubtedly habitually impose the three year limitation rather than anything longer. Thus it will prevent rather than encourage development.

3. PROPOSED POWER TO DECLINE TO DETERMINE SIMILAR APPLICATIONS AND TWIN TRACKING (CLAUSE 42)

There is enormous benefit in resubmissions if circumstances have changed. It would also be very uncertain for all when an application should be deemed "similar" to a previous one.

"Twin tracking" can assist the process greatly by allowing the applicant to start the appeal process with one application, whilst still having the ability to revert to the other if progress with the application, in the meantime, is made. This avoids what both developers and local authorities perceive as the "nuclear option."

We do not believe that an unacceptable burden is placed on an LPA if it receives a planning application which it regards as similar to one which has recently been refused. If it is not thought that the development plan and other material considerations have changed, the planning officers can, subject to further consultation, adopt the bulk of the Report to Committee which was prepared in relation to the earlier application.

4. PROPOSED LOCAL DEVELOPMENT ORDERS

Whilst Local Development Orders are welcomed, the proposed ability of a local authority to revoke an Order at absolutely any time creates uncertainty. It is unlikely therefore that they will be of appeal to those that must commit financially to schemes. We suggest that an amendment is made so that a planning permission granted by a Local Development Order should remain in force for a certain minimum period – say two to three years.

5. GENERAL POINTS

5.1 Community Involvement and Complexity of Local Plans

We support community involvement in plan making but an increase in such involvement should not come at the expense of clarity of local plans. We believe that the current proposals are far too complex. We do not believe that they can achieve their stated aim of making the system faster, simpler and more effective.

The number of proposed components of local plans would undermine clarity and certainty and therefore concerns us. We are also concerned by the suggestion that the most recent would automatically preside over others.

5.2 Planning Fees

Whilst we support some increase in fees, it is essential that it is accompanied by a commensurate improvement in performance. The Government's own approach when spending money is "*reform followed by investment*". Private sector companies would expect the same approach when it comes to spending their money.

We are also concerned that whilst planning fee reform is being considered in the context of the Planning and Compulsory Purchase Bill, the Government's plans to reform section 106 contributions, widening the scale and scope of what a developer might pay towards "*community benefits*", is not. Considering these two changes in isolation from each other could lead to separate demands being made on development which, when taken together, could make a scheme unviable. This would lead to less desirable development in the future.

APPENDIX E

The problem of stamp duty on portfolio sales - a case study – Bradford Property Trust

Bradford Property Trust (BPT) was the largest quoted landlord in the P.R.S. with a portfolio of 12,000 units valued at £900m. In June 2001 the company was taken private by a highly leveraged joint venture whose business plan was to dispose of ½ of the portfolio and retain of the remainder. To date nearly £500m of property has been sold, mostly as individual units with lot sizes of circa £100,000. Only £200m of this was transacted in portfolios and then only where the portfolios were held in separate corporate entities and could be sold at corporate stamp duty rates. The remaining £300m of properties was sold as individual units and has now left the P.R.S.

This was at a time when new institutional investors have been calling for new stock, but have not been prepared to take on board 4% stamp duty on a portfolio of properties with average investment values of approximately £100,000.