HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on Economic Affairs

Inquiry on

THE ECONOMICS OF THE UK HOUSING MARKET

Evidence Session No. 12 *Heard in Public* *Questions 200 - 228*

TUESDAY 8 MARCH 2016

3.35 pm

Witnesses: Dr David Miles and Mr Paul Johnson

Dr David Smith, Mr Nick Jopling and Mr Chris Taylor

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Forsyth of Drumlean
Lord Griffiths of Fforestfach
Lord Kerr of Kinlochard
Lord Lamont of Lerwick
Lord Layard
Lord May of Oxford
Lord Sharkey
Lord Teverson
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Dr David Miles, Professor of Financial Economics, Imperial College London, and **Mr Paul Johnson**, Director, Institute for Fiscal Studies

Q200 The Chairman: Mr Johnson and Dr Miles, thank you for joining us this afternoon. I am aware that one of you—if not both of you—has to be away sharply at 4.30 pm, so we will do our best to get through the questions and give you an opportunity to answer all the points that we want to raise. Can I start with the Office for Budget Responsibility's forecast that the household gross debt to income ratio will rise to 160% by 2021? We heard last week from Sir John Cunliffe, who has a keen interest in these matters, that although the household debt to income ratio is quite large he believes that the Financial Policy Committee is equipped with the necessary powers to keep the ratio safe at that level. That should be set in the context of the Governor saying that one of the things that most concerns him about the economy is the level of mortgages. Dr Miles, would you like to start by giving your thoughts on the direction of travel and the risks therein?

Dr David Miles: As you know, the stock of mortgage debt relative to household income has fallen quite significantly relative to where it was just before the financial crash. It has been fairly stable over the last few years, but it is probably around 20% of GDP lower than it was just before the crash. The immediate direction of travel right now is more or less flat, at a level significantly lower than it was eight or nine years ago.

I do not particularly take issue with the OBR forecast that it is likely to rise from here o. When house prices are going up significantly faster than incomes, which is something one might expect to last for a long period of time, it is very likely that the stock of debt will creep up a bit relative to incomes, unless the Financial Policy Committee decides that it does not want to let that happen. I have no doubt that it has the tools, if it so wishes, to stop the ratio of debt to household income rising. The issue is not so much whether it has the tools to stop the debt to income ratio rising very sharply—clearly, it does—but what the side-effects would be if it felt that it needed to use them and what the balance is between the advantages of preserving financial stability versus some potential knock-on impact to the wider economy that could be more negative.

I am thinking particularly of a stark example. You could get into a situation where the FPC decided that, if its overriding aim was always to reduce to very low level the chances of an affordability of mortgage problem, it should impose some kind of cap on new mortgages relative to people's incomes that was significantly lower than the recent flow of deals. If it were to do that, there is a question about what the wider impact would be. The people who then could not get into the housing market would be looking for somewhere else to live, and that might be happening at a time when the supply of rental property was squeezed. The FPC has the tools to what you might call preserve safety. If you mean, "Can it reduce to very low levels the probability of a widespread mortgage affordability issue?", the difficult question for the FPC—I know that it is fully aware of it—is: how do you trade off the benefits of that versus some potential negative side-effects of really trying to keep the lid on the stock of mortgages?

The Chairman: Mr Johnson?

Mr Paul Johnson: I do not have anything to add, quite honestly.

The Chairman: I come back to the question of the level. As you say, it is somewhat below what it was and it has been stable over the last three or four years. Do you see a situation in which it could rise above the level that it reached in 2007-08?

Dr David Miles: If over the longer term house prices rose slightly faster than people's incomes, which is not implausible for the UK—I am not saying that it is inevitable, but it is not implausible that that might happen for a very prolonged period—it is quite likely that the stock of mortgages relative to household incomes would rise gradually over time. At some point—it may not be for another 15 or 20 years—you get back above the level we were at just before the financial crisis. It depends very much on what happens to house prices relative to people's incomes.

The Chairman: That would tend to put a lid on house price rises, would it not?

Q201 Lord Lamont of Lerwick: You are trying to balance two factors—the risk of another house price bubble and the effect of its crashing, versus pre-emptive action to stop that, which you think would have wider effects and could be damaging to the economy at large. What exactly do you mean by that? Are you referring to the number of individuals who have a stressed situation? We are dealing in macro numbers, so it is a percentage of GDP, but the relevant issue might be the percentage of mortgage holders who are near a very stressed situation, and for whom a rise in interest rates as a preventive measure might result in a lot of people being unable to pay their mortgages, a lot of repossessions, et cetera. Is that what you meant?

Dr David Miles: I meant that there is always a risk that interest rates rise quite sharply—more sharply than people thought—in a short period of time. If you want to reduce the probability that a substantial number of people will find that a problem to live with, you can reduce it to very low levels by putting very tough limits on how much people can borrow relative to their income. You can make the probability of a problem virtually zero if you put a low enough limit on how much people can lend relative to people's incomes. If you push that to the exclusion of any other consideration and say, "The only thing I care about is reducing that risk to virtually zero", you will end up with an enormous cost. The difficult job the FPC has been given is to try to trade off some residual risks that there is none the less a problem against the benefits of allowing people to borrow enough to become home owners. I am just saying that there is a trade-off. It cannot avoid that.

Lord Lamont of Lerwick: To some extent, it is already doing that. It is already happening.

Dr David Miles: Yes.

Lord Lamont of Lerwick: Do you have any estimate of the number of borrowers who are so extended that even a very modest rise in rates of 0.5% or 0.75% could cause them severe difficulty?

Dr David Miles: My view is that at the moment that risk is significantly lower than it has been in the past. It is quite low, partly because with the introduction of the Mortgage Market Review there are now much tougher tests on new mortgages than there have been in the past as to whether people can afford them if interest rates go up. It is also true that usually the people who get into most difficulty when interest rates go up sharply are those who have borrowed most recently, because they tend to be the people with a larger mortgage relative to their income. They have not had time to pay any of it off, and their house may be worth only a bit more than the mortgage. The number of people who have been taking out new mortgages and the number of new owner-occupiers has been quite small in recent years. For both of those reasons, the number of people who are at risk over the next few years is rather limited, in my view.

Q202 Lord Layard: If mortgage finance involves that risk of instability, is there a role for greater outside equity? How can that be promoted?

Dr David Miles: There is a lot to be said for financing part of the purchase of housing with an equity contract, which means that the amount you need to repay on that part of outside financing goes up and down with the value of the house. Obviously that does not happen with a standard mortgage, which is one of the reasons why people with standard mortgages are quite exposed to the risk of house prices moving up or down.

The equity contract has a lot of attractions, because it is a form of risk-sharing with the person who provided the outside finance. As I suspect you know, there have been quite a few attempts in the UK and other countries over several decades to get a mortgage market going with this feature. They have not worked very well in the past. The most successful thing has come from the Government, with the equity loan bit of the Help to Buy scheme, which has that characteristic of risk-sharing. The interesting question—I am not sure that I have a very good answer—is whether or not that scheme, which has proved rather attractive, will be followed by a growing private sector market in equity funding for people buying properties.

One reason why it has not worked very well in the past is that it has been a rather asymmetric form of contract. In the past, those deals normally had the characteristic that I would lend you some money to buy the house and if house prices went up I would take a share—maybe quite a large share—of the upside. If house prices went down, you as the home owner would take the hit and would have to pay me back all the money I had lent you. In the past, they were not really a very attractive form of risk-sharing. The Government scheme is a more symmetric risk-sharing. If house prices go up, you pay the Government back more; if house prices go down, you owe them less. The interesting question is whether proper risk-sharing contracts might arise in the future. There have been some attempts. A few years ago, there was a company that attempted to offer a deal similar to the government deal; I think its name was Castle Trust. It has been a slow process for the company, although it is trying to make a go of it.

Q203 Lord Kerr of Kinlochard: I have a question for Professor Miles. You have written that one of the reasons for house price inflation is the availability of mortgage finance. Are you sure that that is the chicken and not the egg?

Dr David Miles: They interact, in the sense that one of the drivers of mortgage debt having risen quite sharply over recent decades is that there is strong demand for property and property prices have gone up. At the same time, the terms on which mortgages are available are a driver of the level of demand, so there is an interaction between the demand side and the price of the finance available.

There is a common view that we sometimes hear—a mistaken one; you were not putting it forward yourself—that interest rates were kept at too low a level in the decade before the financial crisis and that was a major driver of house prices having risen so much. I am not terribly persuaded by that argument. Interest rates in the UK in the 10 years leading up to the financial crisis were, if anything, slightly higher than those in most other developed economies. On the whole, they were slightly higher than those in the eurozone and in the United States. What happened before the financial crisis was not so much that the rate of interest that the central bank set was obviously too low but that, particularly in 2005, 2006 and 2007, there was a rather frenzied scramble for market share by the mortgage lenders. Frankly, that meant that they were offering mortgages to new buyers—not to existing buyers—at a cost that was almost certainly losing them money on every mortgage, in the hope that some of those people would get a very good deal upfront but that a few years later some of them would not notice when they quietly put the interest rates up. That form of pricing and rather unfortunate competition was a driver of the rapid rise in house prices in 2005, 2006 and 2007. The world has moved on. I suspect that the model of competition—that model of pricing—where you offer new buyers who want to borrow a lot a lower interest rate than existing buyers who are a much safer bet has gone. I would not say that it has gone for good, but it will not come back for a very long time.

Lord Kerr of Kinlochard: Thank you. Can I ask Mr Johnson something completely different? It is about second-hand homes. We have seen evidence that in the late 1980s about 2 million second-hand homes came on to the market every year. Now it is only about 1 million. What is the cause of that? Should the Government be doing something to try to encourage people to move on?

Mr Paul Johnson: There is a problem of supply or turnover in the housing market. The lack of willingness to sell, despite the extraordinary prices around, is creating a lack of supply. Clearly a number of things underlie that. One that is quite important, no doubt—although I cannot give you the scale of how important it is—is stamp duty, which is a much bigger fraction of the cost of a house now than it was back in the 1980s. If you look, for example, at the Office for Budget Responsibility's projections of the amount of revenue that the Government will get from stamp duty, you see that it is very dependent on the number of transactions. The number of transactions that it has been projecting has been coming down year by year—partly, no doubt, because of the scale of stamp duty, but partly, it seems, for extraneous reasons. I would certainly put stamp duty high on the list of suspects as regards the reasons for the lack of turnover in the housing market.

Q204 Lord Layard: I want to come back to the role of finance in determining the prices of houses and housing land. Obviously in the short term there is an effect from the availability of finance, but how much of the strong long-term upward trend in real house prices can you attribute to financial factors?

Dr David Miles: Part of it. This is a slightly vague response to a profoundly difficult question, but there is quite a significant chunk over the last 20 to 30 years. It is not so much the Bank of England, which can set the short-term nominal interest rate; it is more what we might call the global real interest rate, which has been on a downward trajectory for probably 30 years. Thirty years ago, the real interest rate on longer-term government debt was probably about 3% or 4%. It is now marginally negative. That is an enormous change—not just in the UK, but in most developed economies. If you think of the value of a house as the present discounted value of the future rents that you might get from owning it, when you change that discount rate by as much as taking 3% off it, it is probably worth a lot on the level of house prices.

Long-term real interest rates coming down is a phenomenon of the last 25 to 30 years, but house prices were going up in the UK even before that. Over the very long term, more important, probably, than the decline in real interest rates over the last 20 or 30 years is the whole issue of the supply of land, how many houses we build and restrictions on building in the areas where house prices have gone up most, around London. Obviously that is an enormous factor.

Q205 Baroness Blackstone: I would like to go back to the point you made about stamp duty. It has been put to us, and it is very obvious to anybody who knows anything about the housing market, that there is a lot of underoccupation by older people. There are a variety of reasons for that, but would you favour having a relief on stamp duty for older owner-occupiers, to encourage them to downsize?

Mr Paul Johnson: There are a number of blockages to downsizing. Stamp duty is certainly one of them, because you need a big difference in price to release equity. We also undertax big houses through the council tax system. More expensive houses are much less heavily taxed than less expensive houses. There is no annual charge on you for occupying an expensive house. Clearly there are issues around how you would do that in an acceptable way, but the cost to you of continuing to occupy a big house is very low, even if you have a tax that is proportional to the value of the property, rather than regressive. Within the remit of the tax system, those are clearly two changes that you could make that would incentivise more moving and make doing so less penalised. I do not know whether you would want a particular relief for older people. There will be a case simply for making a revenue-neutral shift from stamp duty to council tax.

Q206 Lord Lamont of Lerwick: I go back to Lord Kerr’s chicken and egg. I rather sympathise with Lord Layard’s implication that the longer-term culprit is more likely to be land. If you go back to the period when the Government started their schemes for first-time buyers and Help to Buy, a lot of people criticised those because they were adding to demand, but, at the same time, mortgage availability for first-time buyers was on very restrictive terms and the amount of mortgage lending was very small. Did the Government really have any alternative but to take that step? In a way, it kick-started the market.

Dr David Miles: I have a lot of sympathy with that. As you rightly say, at the time those schemes were launched, the amount of net new mortgage lending in the UK was extraordinarily low. Indeed, even now, when there has been quite a lot of repair in the financial system, the amount of net new mortgage lending is running at much lower levels than in the 10 or even 15 or 20 years before the financial crisis. I do not think that one could look at the most recent experience of relatively rapid rises in house prices over the last couple of years, relative to consumer prices, and say that it is clearly being fuelled by an explosion in mortgage lending encouraged by government schemes.

Q207 Lord Forsyth of Drumlean: Mr Johnson, you made the point that it does not cost older people who are living in the family home a lot to live there, but surely there is the opportunity cost of the property. Instead of staying in a six-bedroom house that is worth £3 million, they could decide to downsize and cash in the money, so there is an opportunity cost. Surely that is not an argument for putting a tax on them. They are choosing to deploy their capital in a way that suits them.

Mr Paul Johnson: Clearly you are right; there is a big opportunity cost in doing that. The role that stamp duty plays is significantly to reduce that opportunity cost. Indeed, the structure of council tax also reduces the opportunity cost, because it rises less than proportionately with the value of the property. You make an important point. It is important not to overstate the role that the tax system plays. We have known for a long period, and from other countries' experience, that quite often older people are reluctant to downsize, for all sorts of other reasons. There is no golden bullet that will suddenly result in a massive change in behaviour, but at the margin it is clearly pushing in that direction.

Lord Forsyth of Drumlean: Are the changes in inheritance tax not far more important, because they encourage people to hang on to the property? The tax implications are far more important than the stamp duty.

Mr Paul Johnson: All those things push in the same direction—towards investing in owner-occupied property, staying in owner-occupied property, not moving out of the owner-occupied property you are in and, in particular, not downsizing. I struggle to say which of those is bigger, but it is clear that all the signals in the tax system push the same way.

Lord Forsyth of Drumlean: I have a question for Dr Miles. Perhaps I am wrong in this, but when I was young, at the end of the 1970s, you could buy a one-bedroom flat in Pimlico for what you would now pay in stamp duty on that flat. The big change that started the market after the secondary banking crisis was when the building societies started to lend on conversions. Prior to that, they would not lend more than 60% or 70%, if you were lucky, and you had to have a building society account for at least a year or two years before they would give you more. Is the issue not the availability of credit, as well as the cost of credit? I am now criticising something I supported; deregulation and the availability of credit has been an important factor in driving this.

Dr David Miles: Yes. I would not want to deny that. You are right. The major deregulation in the mortgage market in the UK is a phenomenon of the very late 1970s and the early part of the 1980s—a period of very rapid increases in house prices. I suspect that most of that freeing up of the availability of finance had played through by the end of the 1980s. It may well have been a prime driver for a lot of inflation, but clearly house prices have gone up enormously in the period from 1990 to today as well. I do not think that there has been the same pace of further financial liberalisation in the UK—there may have been rather little, actually—after the enormous liberalisation in the 1980s. There have been other factors at play in the last 25 or so years, since the early 1990s, one of which is the global decline in real interest rates. The other is the interplay of rising incomes, rising population and restrictions on housebuilding.

Lord Forsyth of Drumlean: Remember that in the 1990s interest rates got up to 15%.

Dr David Miles: They did, in the early 1990s—absolutely.

Lord Lamont of Lerwick: In the 1980s.

Lord Forsyth of Drumlean: Sorry.

Dr David Miles: They came back down again.

Q208 Lord Turnbull: Can I come to fiscal policy? This whole problem looks to me like grandmothers and babysitting—one is able and not willing, and one is willing and not able. You have the large builders, who have the planning permissions and the access to finance, but they are not really interested in accelerating their rate of build very much. Then you have local authorities and registered social landlords, who are absolutely keen to expand their building—for rent, for shared ownership or even for ownership. The argument against allowing the latter is that you have to relax their borrowing. Are there ways in which either local authorities or housing associations can expand their capital that do not add to the recorded figures for public sector debt? If it does add to public sector debt, does it matter? Public sector debt is net of the assets that you are financing. If you have an increase of £1 billion in public sector debt and there is £1 billion in housing assets, what the hell? Why do we worry about that?

Mr Paul Johnson: I am afraid that, as you know, it is a fact of the way the national accounts work that, if we sell an asset for what it is worth, that appears to reduce debt and borrowing and, if we pay for an asset what it is worth, that appears to increase debt and borrowing. That is the way the fiscal aggregates work. In saying that, it is clear that that is not the only thing one should think about. The overall government balance sheet and the change in that clearly matter and should be taken into account when you are making those sorts of decisions. You can take that into account in all sorts of decisions, whether on building roads or building houses. Houses are actually easier to value. They have a clear resale value in a way that a lot of other government infrastructure does not, so they are closer to something you can value immediately, with a clear value on the balance sheet that could be shifted off. I certainly have sympathy with the idea that the way we currently consider the government balance sheet is not wholly rational. I do not think that the answer is to come up with all sorts of fancy financing plans to get things off balance sheet. We have tried that in all sorts of areas, but it tends to end in tears in one way or another, and to end up being much more expensive. We have to think about what the appropriate things to worry about on the balance sheet are and how to value them.

Lord Turnbull: Do housing associations really belong on the public sector balance sheet? There has been some quirk that dragged them on to it, and there is some consideration as to whether that should be reversed. Why are they not in some other sector, outside general government? Their borrowings elsewhere are underpinned by the rents that they can charge or housing benefit. It seems to me that we have unnecessarily maximised the presentation of disadvantage of housing association activity.

Mr Paul Johnson: The intention is that they do not stay on the government balance sheet. Whether they are on or off should not make a great deal of difference to what the appropriate policy is. It is important to be clear: even if they are off the government balance sheet, it is pretty clear that public policy and the taxpayer underpin that debt to a substantial extent, for exactly the reason you describe—a very large majority of people in housing association accommodation receive housing benefit, so effectively it is paid for directly by the taxpayer in any case. The impact of housing benefit in this whole thing is incredibly important in understanding the way in which the money works around the system. Even when they are off balance sheet, housing associations can borrow at pretty low rates, essentially because the market believes that the Government will continue to support them through the housing benefit system.

Lord Turnbull: The other way in which they would fund themselves, if they were allowed, would be by recycling of properties, but that is getting capped as well.

Mr Paul Johnson: Yes. If you make them work as separate institutions, they ought to have the freedom to bring in money as a result of selling properties, given that they are meeting a public policy requirement.

Lord Turnbull: The effect of restricting the building of housing for rent is that waiting times go up, which is a hidden social problem, and rents go up and the housing benefit bill goes up. We are always saying that we do not want that, but we are feeding the thing that is driving the housing benefit bill.

Mr Paul Johnson: Of course, housing association and council rents are set by regulation. In a reversal of policy, they are set to come down by 1% a year for the next few years, having gone up over a long period.

Lord Turnbull: Is that not a short-term response? It reduces the growth of rents temporarily, but if it reduces the rate of housebuilding, you have made the problem worse five years down the line.

Mr Paul Johnson: You are right. If it reduces the resources available to housing associations, as it will, it is likely to reduce the number of new properties built. Of course, in the private sector, the way in which, historically at least, the housing benefit system interacts with the private rental system has been potentially damaging, in the sense that there is some evidence that the availability of housing benefit up to a level has an effect on rents themselves. Of course, we are now moving to a different system, in which housing benefit levels are pretty much decoupled from rent levels in the private sector. Potentially, that has much bigger social implications going forward. Whereas historically people had their rent paid, prospectively and, to some extent, already, increasing numbers are not getting their full rent. That is a big change in both housing policy and social policy.

Lord Turnbull: All these things have in common a kind of time preference—the time preference of dealing with the thing that benefits the Government in the short term at the expense of where they want to be a decade hence.

Mr Paul Johnson: As regards the Government position, there are a lot of time preference issues that have changed. There has been a long period of seeing rents in the social sector rise. In the short run, that is a little bit cheaper for the Government, because some people in the social sector are paying full rent. With a focus on the benefit bill, the Government want rents to fall, in order to get the benefit bill down, but there is a cost, both in lower housebuilding and in lower rents being paid by those who are not on housing benefit. As with most of these things, there are pretty much inescapable trade-offs.

Q209 Lord May of Oxford: I would like to follow this up in a slightly curious direction. As I understand it, the current tax system supports landlords over ordinary home owners in a way that makes renting a very safe investment. Through various bits of luck, I won some rather nice prizes a little while ago. After thinking about how to invest them, we invested them in buying things to rent. I now feel that that was a slightly immoral thing to do. We could afford to do it, and it worked extremely well. That kind of encouragement to build houses to rent makes it harder for people who are not so well-off. It would be much more moral if similar incentives were offered for investing in industry perhaps—or am I just way off-track?

Mr Paul Johnson: There are two different issues. I do not think that there are tax benefits to buying to let relative to buying as an owner-occupier—indeed, rather the reverse.

Lord May of Oxford: It seems to me not to be in our general interest.

Mr Paul Johnson: If you buy to let, you pay income tax on the return and capital gains on what comes out when you sell it at the end, which is not the case for owner-occupiers. The current system is clearly more tax favourable towards buyers and owner-occupiers than it is towards buy-to-let landlords and renters. The tax system is not, and was not, even before the recent changes, more generous to people buying to let.

There is a second issue, related to the other point that you were making, which is about equity between those who are well-off and have generally been lucky in the housing market over a period, in the older generation, and those in the younger generation, who may not yet be in the owner-occupied housing market. You might want to tip the scales of the tax system further in favour of young people who want to be owner-occupiers, against people with substantial sums that they can invest in buy-to-let property. That will be a deliberate tipping of the scales towards owner-occupation to an even greater extent than is the case at the moment. If you want to make an argument, that is the argument you should make. I do not think that it is reasonable to make the argument that the tax system as it stands favours buy to let.

Q210 Baroness Blackstone: First, do you think it right for the Government to support one form of tenure over another—in other words, to be so particularly committed to owner-occupation, as against other tenures? Secondly, is there a case for a capital gains tax on owner-occupiers when they sell?

Mr Paul Johnson: The first question is really a political one for Government, which I am not going to express an opinion on, except to say that current policy has resulted in a situation that has provided an unintended windfall to a particular group of the population, particularly those over 40 or 50 and those who are relatively well-off. The long-run impact of that will be that inheritance becomes increasingly important to the younger generation's ability to get into the housing market and, indeed, to its well-being in later life. That is an unintended consequence of a whole lot of things in the end, but particularly of the inadequate supply of housing. In the long run, all of this comes down very substantially to issues of the supply of housing.

Capital gains on owner-occupation is a very complex question, in the sense that it depends on what tax system you want to get to. At the moment, you can think of housing as being taxed a bit like an ISA. You buy your house out of income, after it has been taxed, and then you pay no more tax on it. That is not a silly way to tax something, but it has had the effect historically that these huge unearned gains have been completely untaxed. Think of the pension tax changes that are not going to happen next week. The way we tax pensions makes a lot more sense, because you buy them out of untaxed income and, if you do terribly well, you end up paying tax at the end. There is a case for taxing some of the excess returns that owner-occupiers have achieved. There is a very difficult case for saying you should do so retrospectively. People bought on one set of presumptions, so you would probably want to do it only prospectively.

Baroness Blackstone: How would you make that work?

Mr Paul Johnson: It would be very difficult. First, yet again you are entrenching privilege for a particular generation and punishing the next one. The second problem with it is that it could only possibly work if all parties were committed to it. If you thought that any party that might get in within the next 20 years was going to stop doing it, you would not sell your house before then, for sure, so it might reduce transactions in the market even further. You might want to have lots of ways of rolling this up as you move up through the housing market. In practical terms, it would not be straightforward.

Dr David Miles: I very much agree with what Paul Johnson said. Even before the tax changes that are about to come into effect for buy-to-let people, the tax system seemed to me strongly to favour owner-occupation. That will become exacerbated very soon, with the extra stamp duty on buy to let and the other tax changes. There is no good reason at all for having the tax system favour one form of tenure over the other. It is not as if having a lower owner-occupation rate is a disaster in itself; far from it. There are many successful countries that have much lower owner-occupation rates than the UK. Indeed, across the world as a whole, an absolutely crude correlation would suggest that some of the poorest countries in the world have the highest owner-occupation rates. There is no evidence at all that having a high owner-occupation rate is in itself a good thing for economic performance, welfare and happiness.

Q211 Baroness Wheatcroft: We have heard repeatedly that builders do not build out their estates fast enough; in fact, a third of planning permissions do not even get acted on. If the Government are to reach or get anywhere near their housebuilding target, do you think there is a motive for putting a tax on planning permission, or on the land that has it?

Dr David Miles: I hesitate, because I have always been puzzled by the argument that you hear—very sensible people put it forward—that builders have incentives to sit on land and so on. I know that builders always say it is not true.

Baroness Wheatcroft: They have said that to us.

Dr David Miles: I am sure they have; they are consistent. I scratch my head a bit to think about what economic incentive they might have to do that. Leaving land with permission to develop and not developing it could make sense if you were convinced that land prices were about to go up very sharply, but why would that be a rational thing consistently for housebuilders to believe? If they believe it, why do other people not believe it, so that it is already reflected in the value of the land they have to buy? One gets into all kinds of funny puzzles as to why they would do that.

Baroness Wheatcroft: I do not think we have had a clear picture emerge. One argument that we have heard from smaller housebuilders is that more houses would be built if the major builders could be persuaded to let them have a bit of the site—obviously at a fair price. One way of encouraging them might be to have a tax on the land. If you are not persuaded by that, do you think that there is an argument for moving away from our current taxation on property to taxing the land, rather than the homes? Mr Johnson referred to the fact that council tax does not effectively bring in enough money from those in very large houses. Should we re-examine the whole issue?

Dr David Miles: On the second question, there is a very strong argument for having property taxation, possibly even as a flat common percentage per year of whatever the value of the property is. That might be just the land value, or it could be the overall value of the property—the land plus the structure built on it. There is a lot to be said for that. If you were to levy that tax at somewhere between 0.5% and 1%, you could probably raise as much revenue as is raised from stamp duty and council tax added together. I looked at some numbers before coming here. I thought that a number somewhere between 0.5% and 1%, as an annual tax on the value of a property, was likely to bring in at least as much as the sum of stamp duty and council tax.

Baroness Wheatcroft: Would you put that tax on land that had not yet been built on as well?

Dr David Miles: I guess that one would. In a sense, it would be a tax on residential land, whether or not it had been built on. This is a very simplistic point—Paul Johnson will probably sort me out on it—but here is one argument for a number of the order of 1% being a plausible estimate of how much one might tax each year the value of the land. It goes like this. One thing that is not taxed at the moment is the implicit rental that owner-occupiers receive from living in their own house. Suppose you could measure that and wanted to tax it. If you thought that it should be taxed at the average rate of other goods that people consume, you would use the VAT rate, which would be 20% of whatever you thought the imputed income of living in the house for a year was. If you thought that the imputed income was something like 5% of the value of the property, which is about the average rental rate on properties, you would get 5% times 20%, which would get you to about 1%.

Baroness Wheatcroft: That is interesting. Mr Johnson?

Mr Paul Johnson: There are two things. There is certainly a case for thinking about council tax in exactly the way that David describes—as standing in place of VAT on owner-occupation. If you are renting you are paying VAT, or if you are buying anything else in the economy, but if you are in owner-occupation you are not, so why not think of council tax in that way? Actually, I am not sure that that is true of renting. If you think about other goods and services that you consume, you pay VAT, but you do not do so for occupying a house, except through council tax, which is a bit like VAT, except that it is not flat rate but regressive. That is a useful way to think about it.

There is a separate question, which is about the taxation of undeveloped land. As you know, it has a very long history in economics. There is a strong case for land taxation, for precisely the reasons you describe. The correct tax to levy on some land would be its value if it were used to its maximum economic extent, which is precisely how you would think about any undeveloped land that housebuilders held. It seems to me that there is a case for that.

Baroness Wheatcroft: That is interesting. Thank you.

Q212 Lord Forsyth of Drumlean: If you introduced those taxes, would they not in the end just be passed on to the purchaser and thus add to the problem, which is that people cannot afford to buy houses?

Dr David Miles: They might reduce house prices, at the point at which you brought them in. Let us say that it is a 1% tax every year on the value of property. It would have differential effects on more and less valuable houses, but to the extent that it corrects a degree of undertaxation of housing, because people in owner-occupied housing do not pay tax on the implicit rental income that they do not have to pay to themselves—

Lord Forsyth of Drumlean: But why should they?

Dr David Miles: Because they are consuming a good, in the same way that, when you go to the supermarket and buy a load of goods there, you pay VAT on most of those.

Lord Forsyth of Drumlean: We do not have a system where we get our revenue through a consumption tax model. We have a system where we tax people on their income.

Dr David Miles: Not with value added tax. That is where I got my number of 1%.

Lord Forsyth of Drumlean: I know. I find it quite difficult to understand the idea that, if people save all their lives, work very hard and buy themselves a house, the state has the right to tax them because they are enjoying the house they worked for. What is the justification for that?

Dr David Miles: If you work very hard, earn income and then buy a TV, you pay VAT on the TV.

Lord Forsyth of Drumlean: Yes, but you do not get taxed on your TV every year.

Dr David Miles: No, but you were taxed on the income that you had to earn to buy the TV—and then you pay more. I think it is analogous.

Mr Paul Johnson: Part of the issue is retrospection, as against what is prospective. The change is very difficult. You earn your income in the expectation that if you buy a whole bunch of things you will pay VAT on them, but you buy your house—or you bought your house in the past—in the expectation that you are not going to have a series of taxes levied on it. It is a profoundly difficult and important issue. In a sense, you are absolutely right. It is very difficult for the state to come along 20 years after someone has bought a house on the basis of a set of assumptions, and to start charging extra tax. On the other hand, there are profound consequences of not doing that, as regards the concentration of wealth in a particular generation, the importance of that unearned wealth and the inheritance that results from it—as a result of blind luck, frankly, on the part of the people who, to a large extent, have benefited from that. There are two big ethical issues that weigh against each other. We need to think quite a lot harder about where we come down on that, because which way we do it makes a big economic difference.

Q213 Lord Layard: You are discussing an alternative source of income for local authorities. If so, would one not want to structure it in a way that incentivised them to deal with the housing shortage and the shortage of permissioned land? Your tax on all land is a tax on land that was already permissioned. Would it not be better to focus it on newly permissioned land—marginal permissioned land—to incentivise them to permission more land?

Mr Paul Johnson: If you did it on all permissioned land, it would have that effect on the newly permissioned. There has long been a case in favour of that kind of planning gain, essentially. The worry—as you know, this is why it never worked terribly well in the past—is that holders of land hold on to it in the hope and expectation, which has always been proved true, that the tax is got rid of. In principle, I agree with you rather strongly. In practice, I do not know how policymakers bind their hands and the hands of their successors to be absolutely definite to those who might be affected that this will exist for ever more. That is a serious practical problem.

Lord Lamont of Lerwick: I have some sympathy with the view that housing, particularly capital gains, may be undertaxed vis-à-vis other assets, but obviously it is politically very difficult. I wonder whether the whole business of housing being undertaxed is not a bit of a red herring. When you go back a few years, you see that there have been big changes in the taxation of housing. First, we had mortgage relief being denied for equity release. Then we had interest deductibility for higher-rate payers taken away, and salamied away from basic rate payers as well. At the time, it was thought that all of that would stop the rise in house prices, but it has had absolutely no effect at all. There must be something more fundamental than the tax system that is driving up house prices.

Mr Paul Johnson: There is. The fundamental issue is the supply, for sure.

Lord Lamont of Lerwick: Yes. All this talk about taxation is a bit of a waste of time.

The Chairman: Lord Sharkey, you had some questions not about taxation.

Q214 Lord Sharkey: I was not going to talk about taxation; I was going to take you back briefly to what incentives builders might have or what might cause builders to build out faster. You said that there were none you could think of in their business model. What, therefore, do you think are the key factors that determine the rate at which builders actually build houses?

Dr David Miles: I am not sure that I have anything very helpful to tell you about that. I am not really on top of the facts, as regards how much undeveloped land they are sitting on, what that stock is relative to the flow of completions over a period such as a year, whether the stock of undeveloped land relative to the flow is higher now than it was, or whether it appears to be higher in periods when there is an expectation of land prices going up. The facts are very murky on all this. I continue to scratch my head about what their incentives might be, to be honest. Although one often hears the statement that they sit on land and that there are land banks and all the rest of it, I do not find it terribly convincing.

Mr Paul Johnson: I am as puzzled as David, quite honestly. We know one empirical fact about the number of houses being built: the gap between the number being built now and the number that was built when most houses were being built, in the 1960s and 1970s, is entirely accounted for by the fact that the public sector is no longer building houses. It is not that the private sector is building any fewer; nor, on the other hand, is it building a lot more to fill the gap. There seems to be a remarkable regularity. More houses were being built in the past, but the difference between now and then is essentially the difference between public sector housing now and public sector housing then. I do not understand or know why private housebuilding has not filled that gap. It is an incredibly important and interesting question.

Lord Teverson: I have just done my own calculation. If I had 1% tax on the non-mansion I live in, my annual expense would probably be four times what it is at the moment, which shows the political barrier there may be to that. I understand entirely the theoretical economic argument, which I am sure a publication such as the *Economist* would love, but it is probably fairly difficult to deliver. There is also the issue of doing valuations. Governments tend to avoid uprating of valuations. I have a question for Dr Miles, primarily—or first. Is there an inconsistency between the setting of interest rates to meet inflation targets, as the Bank of England or central banks are expected to do, and the setting of rates necessary for stability in the housing market? You stressed that there is a particular divergence when you have a particularly hot housing market that is moving, in colloquial language, out of control. Interest rate policies can then be very blunt and can have counterconsequences in that area.

Dr David Miles: There could be an inconsistency. If interest rates are the only effective tool to try to prevent bubbles and volatility in house prices, clearly there can be a problem of consumer price inflation running at beneath some desirable level, as is the case now, and house prices rising very fast at the same time. That has happened at times in the past. There could certainly be an inconsistency. You can make one of two choices. Either you say, "We just have to live with that. When it happens, we have to sacrifice one for the sake of the other", or—I think this is the road we are going down, and it is a better road—you make sure that you have some other policy levers, besides interest rates, to try to keep a cap on potential bubbles and volatility in the housing market. That is where the Financial Policy Committee and the tools that it has come in.

My view is that, to a large extent, not the Financial Policy Committee but the Mortgage Market Review, which came into effect almost exactly two years ago, may reduce the problem substantially in future. The key element is that lenders now have a clear and explicit responsibility to assess affordability of mortgages. Can people live with interest rates suddenly going up by 3%—I think that is the number they have to deal with at the moment—relative to when they took out the mortgage? If that works in the way it is supposed to work, the potential difficulty is very much reduced.

Lord Teverson: From what you are saying, it seems that you think that the balance has been struck fairly effectively so far, using some policy instruments to correct others.

Dr David Miles: Time will tell; it is very early days. My impression is that it has been a very big shift. Lenders now have an explicit responsibility to assess the affordability of the mortgage. I think they will take that responsibility very seriously. After all, no lender wants to get into a position four or five years from now where interest rates have gone up, a bunch of people are finding it very difficult to pay the mortgage and claims management companies are ringing those people and saying, "You must have been mis-sold the mortgage, because it was the responsibility of the lender to see that you could live with interest rates being substantially higher. You have not been able to live with that, so we will handle a claim for you. The lender has mis-sold you the mortgage”. Given the experience of PPI, lenders take that extremely seriously.

Lord Teverson: In a way, that itself creates an intergenerational problem, does it not? The restrictions make it very difficult to have the start in life that we all had but that the next generation does not.

Dr David Miles: You are right. It cuts off a potential short-term get-out of the problem of not building enough houses and having house prices go up. You can try to get around that problem temporarily by having a financial system in which people borrow ever more relative to their incomes and can still get into the housing market, even as house prices move up very sharply. You can try to play that game for a short while, but it always ends in disaster.

Lord Teverson: It is like a lot of government interventions. To a degree, it is like putting sticking plaster on sticking plaster, is it not?

Dr David Miles: In a sense, the mortgage market review means that it is not an option even in the short run to try to go down that road.

The Chairman: That brings us to the end of the session. Gentlemen, thank you very much.

Examination of Witnesses

Dr David Smith, Policy Director, Residential Landlords Association, **Mr Nick Jopling**, Executive Director of Property, Grainger Plc, and **Mr Chris Taylor**, President, British Property Federation

Q215 The Chairman: Gentlemen, welcome to the Economic Affairs Committee housing inquiry. Thank you very much for joining us today. We are keen to learn more, and to have more insights into the private rental sector. Can I start by asking you what factors have led to the significant increase in that sector over the last decade or so? Do you think that those factors will continue to lead to increased demand over the next few years, and will that be to the detriment of the social housing and first-time buyer sectors? How do you think it fits into the overall picture? Mr Taylor, would you like to start?

Mr Chris Taylor: Of course. Thank you very much. As a long-term investor—I am head of private markets at Hermes and president of the British Property Federation—I see that there are profound demographic lifestyle changes taking place in this country. There is also a long-term trend of urbanisation. We are involved with the project at King's Cross, with which many of you will be familiar. Today we announced a regeneration in Birmingham, at Paradise Circus. We are also working in Leeds. As a long-term investor, we have an absolute conviction that there is £60 billion, £70 billion or £80 billion of long-term patient institutional capital that would be attracted to investing in the private sector.

The Chairman: What would that be? Could you express it as a number of units?

Mr Chris Taylor: Yes. It is difficult, but very crudely, to give you an idea, it could be somewhere between 400,000 and 500,000 new dwellings—of different sizes, obviously. The reason why we have that conviction is our experience from the US, Holland, Germany and, in fact, most countries in the world—with the exception of Australia, interestingly enough, which is now on the cusp of those profound changes, as I believe we are in this country. The reason why institutional money would be attracted to the sector is quite simply that there is a craving from institutions to secure long-term, stable, inflation-matching income streams. There is plenty of evidence to suggest that long-term private rented sector income streams would be a very good hedge for institutions, for inflation-matching.

Dr David Smith: To go back to the question you asked, there is a range of factors around the increase in the private rented sector. Perhaps the most important—certainly the one that will cause increase in the sector—is that the private rented sector is being asked to do more than ever before. It is being asked to house more people across a wider range of demographics. As a consequence of the Localism Act, which allows local authorities to discharge their homelessness duties in the private sector, the private rented sector is now being asked to house new types of tenant who were not traditionally housed in the sector and who are coming directly from street homelessness or temporary accommodation. That is leaving aside other social changes—simple factors like rising population, but also the change in the way people leave home and the type of accommodation they wish to move into. Those are all factors as well.

I will politely differ from Mr Taylor—unsurprisingly, given that I represent an organisation that represents smaller landlords—and point out that 80% of the private rented sector is small landlords owning five properties or fewer. Institutional investment has been discussed in the private rented sector for 30 years, since the introduction of the Housing Act 1988. In 30 years, it has not formed a significant part of the sector. While it is undoubtedly the case that institutional investment will increase, we do not think that it will change the overwhelming level of small private landlordism within the sector. The attempts at the moment that might alter that, by changing tax structures, are unlikely ultimately to make a huge difference.

I agree with some of the evidence that I caught at the tail-end of your last session. The biggest issue is supply. There are fewer houses than there are people who wish to occupy them. Unless we address supply radically, there will be no significant change in housing cost. Simply shifting the dynamics so that it is more attractive to owner-occupiers than it is to private landlords does not increase supply; it just moves property around a merry-go-round. We must increase supply. Everything else, to some extent, is a red herring that detracts from that core factor.

Mr Nick Jopling: First, I agree with the last point about supply. You heard from the previous speakers, and I am sure you have heard throughout, that this is entirely down to a supply issue. The only way we will deal with the housing problem is by building more houses.

The answer to your question is that the growth in the private rented sector—doubling over 10 years, and significantly more than doubling in the last 15 years—is down, first, to affordability. Effectively, renters are priced out of the buying market. There is also an increasing number of renters out of choice as much as necessity. We are talking about a generation that is often described as generation rent. Sometimes that is said almost as if it is a disadvantaged sector, but actually it is a group of people who have taught us all how to rent music, to rent our films, to rent a bicycle or to use Uber. It is a generation more comfortable with that experience than with ownership. That element of choice should not be discarded.

There will be significant growth in the rented sector. In London, it is already at 30%, estimated to go to just shy of 40% by 2030. There is definite growth. The last part of your question was whether that will be to the detriment of social housing. I think that the private rented sector, particularly the institutional private rented sector, has a role to play in providing some of the stepping stones between those who do not qualify for affordable housing, with a capital A, and owner-occupation, through the provision of discounted market rent within rental provision at scale—providing discounted market rent within the same buildings. We can talk about it in more detail later, if you like.

The Chairman: We heard from Shelter, which carried out a very large survey of private renters, that only a small percentage—it said the figure was as low as 6%—wanted to be there and that the remainder would prefer to be somewhere else. You are painting a picture of a tremendous demand for this—an enthusiastic demand, if I can put it that way. How would you react to Shelter's analysis?

Dr David Smith: The statistics are very inconsistent on tenant desire and what tenants want. The same point would be made about tenancy length, for example. Shelter has been keen to point out the need for longer tenancies, but the reality is that almost no tenants ask for tenancies longer than 12 months and almost no landlords ask mortgage companies to give them permission for tenancies longer than 12 months. Other statistics show that over 80% of tenants are happy with their rented accommodation. I rather suspect it depends who you ask and the way in which you ask the question.

Shelter has a particular constituency. The difficulty is that we keep talking about the private rented sector as if it is one thing. There is absolutely no comparison between, for example, the private rented sector that caters to Members of the House of Commons—the other place—or, indeed, Members here, the private rented sector that caters to young professionals sharing in four-bedroom houses in London, the private rented sector that deals with students in Bath and the private rented sector that deals with people in Leeds. Those are different private rented sectors, catering to entirely different constituencies, with entirely different business models for landlords. One of the difficulties is that we keep trying to stick them all together and talk about them as one thing. To some extent, that is where the statistics that Shelter or other people are quoting to you miss the mark, because they try to create a homogeneous whole out of something that simply is not homogeneous. It is five private rented sectors.

Q216 Lord Forsyth of Drumlean: Everyone this afternoon has emphasised that the problem is one of supply, but is it not also one of demand? We have had a big increase, particularly in London and the south-east, in people who are looking for property but whose incomes are not necessarily particularly high. That has come through migration, for example. How can the private rented sector contribute to increasing supply? What things do the Government need to do in order to encourage that?

Mr Chris Taylor: Let us move outside London for a moment—

Lord Forsyth of Drumlean: My question was about London, but feel free.

Mr Chris Taylor: I was going to give a slightly different dimension, which was that the institutional money that will invest in the private rented sector will purpose-build the quality, sustainable, long-term units that we do not have. There is a place for housing and for the smaller private landlord, but the point about the institutional money is that for the first time in this country we will be able to create purpose-built units, such as the 326 units that we are building with Countrywide in the city centre of Liverpool. That is also an engine for regeneration. It is a conduit for place-making and creating new places.

I would embrace that for London as well. Clearly, the issues in London are very different from those in the rest of the UK. I tend to agree with David. It is such a complex area. Whether it is green belt or not—I am not suggesting that it should be—it probably means greater density and thinking more innovatively and creatively about density. With Crossrail 2, there is already a lot of good work on thinking about the nodes of transport through London, where greater density could be built.

The point I wanted to make was that outside London we see this as a spur for regeneration. It plays to the theme of urbanisation and to the demographic lifestyle changes that are taking place, with younger people increasingly wanting to have the choice to rent. If I told you that I rented my property—me with no hair—there would be a few people frowning, but nobody in here would bat an eyelid at the fact that I rented my car. That is the change we are seeing; younger people are electing to rent. You have seen the PwC forecast that by

2030 40% of people in London—if you include social as well, 60% of people in London—will not own their houses. A sea change is taking place.

Lord Forsyth of Drumlean: Yes, but it is a sea change caused by the fact that they cannot afford to buy their houses.

Mr Chris Taylor: There is a combination. In London, it is primarily about affordability, but behind it there is this demographic lifestyle change—

Lord Forsyth of Drumlean: On the demographic lifestyle change and these youngsters who would prefer to rent, how can the private rented sector provide them with properties that they can afford to rent?

Mr Nick Jopling: Your question goes right to the crux of it. You are asking a question about demand, but it is actually about supply. It is about how we provide more stock.

I will give a very simple example. It is a live example. It is at Waterlooville, so it is not in London, but it could be applicable in London as well. We have a large site outside London, with 2,500 units. It is an urban extension. We put in the infrastructure. Bloor, a medium-sized housebuilder, has started to build phase 1. It is building 200 units in phase 1. About a mile away—it is a big site—Redrow is building phase 2, with 250 units. Both those housebuilders would be happy to sell one unit a week, which would be 100 units a year. We control the site. Grainger has been in the private rented sector for 104 years. We have a long-term, long-hold approach. We have built the school on the site already. It is not up to capacity, so we went to the council and said, "We will build 100 units alongside Bloor, in the first stage, and we will covenant them for rent. Then Bloor and Redrow will not complain about us competing with their absorption rate". David will not necessarily be happy with this, but the difference when an institutional investor adds to the supply is that our commitment is to provide those units for 10, 15 or 20 years—or longer. The site will now deliver 200 units this year, instead of just 100.

That is the only way. The only way we can make it affordable is to build more homes. At the end of the previous session, I heard you ask the two speakers how we can increase supply. There are lots of questions about capacity in the sector, skills, materials, costs of build and all of that, but what we need to look at in this section is that real example of providing something that is non-competing with the for sale product, because it can sell only so many at a time, and really adds to supply, to meet the demand and make it more affordable.

Lord Forsyth of Drumlean: Are the rents that people are paying there affordable?

Mr Nick Jopling: Yes. They are set at the market rent for that particular area.

Lord Forsyth of Drumlean: Which is what?

Mr Nick Jopling: It is about £800 a month, for a two-bedroom semi. We are talking about Hampshire, not London. Take, for example, what the mayor's office did—

Lord Forsyth of Drumlean: I am talking about the example you gave us, which you said was just outside London.

Mr Nick Jopling: Yes, it is at Waterlooville, near Portsmouth.

Dr David Smith: Lord Forsyth, the point that you are making is exampled by Nick. Oddly enough, I live 10 miles down the road from that development. I commute to London every day. I would never buy a house in Waterlooville, because it is not on a train line. Part of the problem of building outside London is that you have to consider communications. With respect, the only places people who live in Waterlooville commute to are Portsmouth and Southampton, which have substantial economies but are not London. There is a difference.

The point that Chris was making about Liverpool is good. It is true that in the longer term we need to build attractive developments out of London, but the economy is not yet in a position where people are prepared to move out of the south-east and telework and telecommute. That is a longer-term issue that the Government need to address in a different way, which may be outside the scope of what you are interested in at the moment. The only way to improve the situation really immediately in London and the south-east is density. The Government have launched a consultation inside London about upsizing houses by sticking another floor on top. That is the kind of thing we would support and that needs to happen, because it is the only thing that will deliver increases in housing in the short term, now.

To come back to the small private rented sector, one thing that small private landlords do very well, and have a very good history of doing, is house conversion. Small private landlords are particularly good, especially in London, at taking larger properties that are not attractive to first-time buyers, because they have four bedrooms, which they do not require—they want one or two—and are outside their price range, converting them into multi-occupancy properties and putting them back into the market at a lower price point.

Q217 Lord Forsyth of Drumlean: We have heard some evidence that with institutional landlords the rents and costs for tenants tend to be higher than with smaller private landlords—people who are running a couple of buy-to-let properties. Do you accept that that is the position? Could you also explain to me why it is right for the Government to give an easier tax regime to larger landlords who are providing properties for rent than to smaller ones?

Mr Chris Taylor: Those are two good questions. I will take the second one first. If there is the conviction that £60 billion, £70 billion or £80 billion of long-term capital could be invested in creating quality, purpose-built, new supply—not converting existing property, but new building that is a conduit for regeneration; you will hear a lot about that from me, because we are passionate about it, particularly in the cities outside London—that seems to me to be a pretty good source of capital the Government should be looking for. It exists in Germany, Holland and America. I see absolutely no reason why that long-term, stable capital should not be here. Clearly we have to prove this to you—I would like to show you Liverpool when it opens shortly—but the quality of the built product will be something that has not existed before in this country. That does not mean that it is expensive. Whether it is a well-run Travelodge or a Hilton, our view is that the price point does not matter; it is about quality and having sustainable materials. We take a long-term view—a 20-year view. We are not just trying to let for the first tenant. Our interest is aligned with long-term occupation, so there are planned maintenance programmes. It is a completely different model.

Lord Forsyth of Drumlean: You have not really answered my question.

Mr Chris Taylor: The second part?

Dr David Smith: It is a completely different model, in a completely different legal system. One of the reasons why Germany has a totally different rental position from us is that the entire legal model that links to renting in Germany is totally different from the one here. The entire investment model is different. People often talk about Germany, but you are comparing chalk with cheese. This is not Germany.

Mr Chris Taylor: To answer your question in a sentence, the capital is there and could be deployed to help to provide the supply that clearly is chronically required. It may not come.

Mr Nick Jopling: It is in no one’s interest to have any kind of division between private buy-to-let landlords and the institutional or corporate build-to-rent sector. We have done a scalable building in Barking. It has 100 units and is there for rent for the long term. The leader of Barking Council can see it from his window and tells me every time I see him that it is an example and a case study. That is the Labour leader of a council talking to a private sector investor and developer of stock. I do not think that there is any evidence whatsoever about higher rents in the institutional sector. Equally, it should be in everyone’s interest to drive the two sectors forward. The difference with the institutional sector, and the wall of money Chris has talked about, is that it is building to rent. That is what it can do. It can build, as in the examples I gave. Incidentally, we also have one in Aldershot, where people do commute to London—I just did not want to talk for too long. The point is that we are building. We are adding to the supply side. That is the key to the problem.

Mr Chris Taylor: It is contributing to the supply. That is the answer.

Q218 Lord Layard: What are the main obstacles to your building at a faster rate?

Mr Nick Jopling: The planning system is hard. Also, when building to rent, sometimes you cannot pay as much in value terms for the land as you can for houses for sale. When you build for sale, the land is worth more over a much longer period than if you fast-forward and provide it for rent, so sometimes it is quite hard to compete. That is why, on the back of the Montague Review, back in 2012, we called for and advocated the use of a covenant, particularly on large-scale pieces of land. We say that where you have over 500 units, for example, there should be a covenant that a certain proportion should be built to rent. You build alongside the for-sale builders. We are not a for-sale builder; we just build for rent and long-term hold. That is one way of trying to level the playing field on the land value equation.

Q219 Lord Lamont of Lerwick: You make a very attractive and persuasive case. If one were being a bit sceptical about it, one would say in reply to what Mr Taylor said that this high-quality, annuity-type return is something that institutions have wanted for a long time. Obviously the hunt for yield is bigger today, but the opportunity has been there. As Lord Layard suggested, why should we believe that institutions coming in should be able to get over the obstacles to build sufficient units quickly enough to affect the price of housing, be it rented or owner-occupied? We have a mystery, which we have heard again and again—the shortage of housing, the demand for housing and the inability of builders to build to satisfy that demand. Why should something be able, just because it is financed by a wealthy institution, to overcome the obstacles that have already prevented the market from working?

Mr Chris Taylor: There are two answers that I would give; I will try to answer the question better than I answered the previous one. One is the experience that we have had elsewhere in the world. I am not suggesting that that necessarily means it would work here, but if one goes to New York and looks at the 2.1 million—

Lord Lamont of Lerwick: When you say "we"—

Mr Chris Taylor: If you go to New York and look at—

Lord Lamont of Lerwick: I know that other countries have rented accommodation. That does not mean that you could build it here and get around the planning process.

Mr Chris Taylor: There is institutional investment in the multifamily sector in the US; 35% of all institutional investment in real estate in the US is in the private rented sector. In this country, it is somewhere around 3%. In Holland, it is 55%. In Germany, it is about 40%. For whatever reason—there are reasons, which we can go into—in the UK we are an outlier. For whatever reason, institutions have not allocated capital in their real estate exposure to the private rented sector. We believe that they will, and they are beginning to do it. Vista, which we have launched with Countrywide, has already attracted long-term institutional capital.

Lord Lamont of Lerwick: Where the Government's policy seems to me very perverse is that at the same time as encouraging institutional building for rent—which I am all in favour of, obviously—they are penalising with stamp duty the smaller landlord, who can provide conversions. I would argue that in some of our northern cities the buy-to-let market provided some new build as well.

Mr Chris Taylor: I agree.

Lord Lamont of Lerwick: I do not see the sense in pursuing such a policy.

Mr Chris Taylor: Nor do I.

Dr David Smith: One area that we have looked at and have advocated in the past is a smaller-scale build-to-rent model. We surveyed a large number of our members, and 46% expressed interest in helping to fund the building of developments of fewer than 10 units.

Coming back to the issue of what will move us forward quickly, one of the big obstacles to building a large development is planning. The reason why there is such a big obstacle is that local people object to very large developments being built on their doorstep. There are far fewer objections to smaller developments, particularly in sensitive areas. Again, I will talk about where I live, in Hampshire, because it is in the South Downs National Park. One of the problems with building large developments there is that it is in the South Downs National Park. Building much smaller developments has a much lower environmental impact and is more attractive. It also works for density. In London, or in areas where there is already a lot of property, you can build smaller developments on more marginal land that is simply not attractive to large institutions and large housebuilders, because they cannot build the 300 or 400 units that they want to get the kind of return they need.

Q220 Lord Lamont of Lerwick: Mr Jopling, in one of your previous observations, you said that some of the units you were building were being made available at a discount. Could you enlarge on that? Is that a profitable investment, or is it just something that you are doing pro bono? What is it? I noticed at the weekend that Cheyne Capital was getting into the rented sector, alongside and in partnership with local authorities. I thought that was a rather interesting piece of news. I do not know whether it is a similar model to yours.

Mr Nick Jopling: You have opened up something that is the other vital part of the equation: where is this land going to come from? It is led partly by Lord Layard's question as well, in that public land has a major part to play.

We do not provide discounted rent pro bono. When we build a building, the one thing that we do not want to do is to sell any of the units, because we are running a building for income and we do not want a load of other people with a different interest to start paying a service charge, for example, or charging their own rents. We want to keep it whole, for rent. That begs the question of how you deal with an affordable housing quantum in developing. You put in layers. Let us take an example where 70% of the building is allowed to be rented at full market rent, 10% at 80% of market rent, 10% at 70% and 10% at 50%. There are something like those numbers in a big building that is being built in Greenwich by an institution. It has done that in conjunction with the London borough, because it considered that you provide those stepping stones not as affordable housing, in the sense of pure social housing that has to be managed by a registered provider, but as something that the institution and the manager can do. It was considered the fair way of being able to party the land together with the institutional money. It was not ignoring needs in the borough.

At Grainger, we are developing with the Royal Borough of Kensington and Chelsea. We are building on six sites in Kensington and Chelsea, on its land. In those particular cases, Kensington and Chelsea said, "We want some four-bedroom houses at totally affordable rents", so we have put them in. That affects the land value for Kensington and Chelsea, but Kensington and Chelsea is taking no risks. We are building all of it. We will build it for rent, and a certain proportion will be at discounted market rent or an affordable rent. As I said, we also doing it in Barking. Those are the lowest-value and highest-value boroughs in London. We are using them almost as bookends, to demonstrate that you should be able to find a point in any borough in London to make this work—on TfL land, on NHS land or on local authority land, working with institutions to deliver rental-accretive volume to meet supply.

Mr Chris Taylor: The other great advantage is that it is socially inclusive. In theory, if you look at the 326 units in Liverpool, you will have no idea which tenant is on an affordable rent and who is paying the market rent. Rather than creating divisions, it is a socially inclusive approach to the problem.

Q221 Baroness Wheatcroft: Mr Taylor, could I go back to your comment that, as far as institutional build-to-let supply is concerned, we are very much an outlier? You said that the figure was 3%. Even that is larger than I thought. People have been talking about this changing for a very long time. What makes you so confident that we are at that moment now? Is it because of the land being made available?

Mr Chris Taylor: Forgive me, but I will repeat myself. It is the profound demographic lifestyle change that is now happening. The PwC numbers that you probably saw last week, which are based on DCLG numbers, are giving data and reassurance to the institutions that the demand is there, particularly from younger people, to rent. This is a sea change. Yes, there is the affordability issue, which I accept, but behind that is a very profound change. In addition, institutions such as our own have learned from our experiences of investing. We are invested in Holland, Germany and the US. We are bringing best practices to bear.

Baroness Wheatcroft: But the private landlord woke up to these demographic changes, apparently, long before the institutions.

Mr Chris Taylor: Yes. I do not disagree with you. There is also data. Institutions like data. The MSCI data on the sector is now there. There are a number of factors in place, but data on rents and yield is important. The index is now 8.6 billion. There is actually an index, which institutions like. When they look at long-term projections, they like to rely on data.

Baroness Wheatcroft: I can see that. Can you give us any idea of how much of this institutional investment is happening now?

Mr Chris Taylor: As I said, we are building in Leeds and Birmingham. We have just secured Pomona Wharf in Manchester. We are building 326 units in Liverpool. I would be very surprised if we are not up to £2 billion or £3 billion within three years.

Mr Nick Jopling: The British Property Federation estimates that 37,500 units are currently being built for rent by institutions. We have just commissioned a 612-unit building in Salford, between MediaCity and Manchester city centre, which is on-site now. We want to deliver the first units to be available by the first quarter of 2018. That is very quick delivery.

Mr Chris Taylor: Another change that we are finding is that the public/private partnership—particularly outside London, whether it is in Leeds, Manchester or Liverpool—is very powerful. There is strong leadership. In Manchester, in particular, they have a vision and understand the need for the private rented sector. The BPF has been working with the local authorities on best practice. There is a snowball.

Baroness Wheatcroft: It is happening.

Mr Chris Taylor: It is happening.

Q222 Lord Sharkey: Can I go back to the question of the provision of public land? Could you give us some idea of the scale of the usage of public land now and prospectively? How many homes do you think will be built for rent in that way? Could you also talk a bit about the Ministry of Defence? To what extent is it able or willing to provide, or providing, access to land that it owns? It has been said that there are a lot of very small plots of publicly owned land, especially in London. What can be done in high-density areas, in particular, with small plots available, to persuade local or public authorities to release that kind of land?

Dr David Smith: I will talk about small plots, because that is something the RLA has made comment on before. At the moment, there is no pressure on local authorities to release small plots. We asked the two proposed candidates for the new mayor, whoever is finally elected, to look at using their planning powers to reconsider that. Currently, the mayoralty's planning interests focus more on building large institutional structures or large buildings that are sold to private sector landlords abroad. We have asked the mayor to rethink his planning powers to look at smaller plots and to encourage or compel local authorities to make them available.

There is also a bonus that is paid to local authorities for making more properties available, but at the moment it deals only with large institutional land availability and plots. We think that should be extended to small properties. We would also like to see a change to the stamp duty land tax that is about to be introduced to give landlords a discount on the 3% increase when they have done something that brings new-build property on to the market. Where they have invested money in new-build property, thereby increasing the overall supply, hopefully, we think that they should be relieved from the 3% uplift that will apply to stamp duty land tax.

Mr Nick Jopling: I do not think anyone knows the answer to the question of how much public land is available. The Chancellor would like to know that and has encouraged it to be released. It is important to look at the examples where it is happening, because I think there is a movement, and a snowballing thing is happening with regard to the scale of institutions coming in. Look at what Birmingham is doing. To encourage this, it has set up its own private rent business to build on its own land. Manchester was referred to earlier. It was partnered with overseas institutional money, initially, but is also using the Greater Manchester pension funds. The GLA is leading by example and has released land that it has said is purely for rent. We are building 234 units at Pontoon Dock, on the DLR site—a GLA site that it said will be only for rent. A third of it will be affordable and two-thirds will be for private rent. It has done the same at Silvertown. For the Sweetwater and East Wick phase of the mayoral development zone at the Queen Elizabeth legacy park—the second phase that came out—the mayor's office said, "There are 1,500 units to be built here; 500 of them are for sale, 500 are for social housing and 500 are for long-term rent". It will do the same at Old Oak Common, I suspect. I referred to Aldershot. On that particular site in Aldershot—the southern garrison site—we are partners with the DIO. On that site, we have 3,850 units to deliver and have permission to do that. Bellway is building the first phase. We are doing exactly the same thing there. We are building 108 units alongside Bellway and covenanting not to sell them, so that we deliver 350 units, not just the 250 from Bellway.

One thing we have to do—it is one of the reasons why I was so anxious and pleased to be able to appear in front of you this afternoon—is to raise awareness. It is about solutions. It is about being able to implement a covenant, particularly on public land, on large-scale sites—not making any comment on or interfering with the private and the buy-to-let investor, but looking at how the large-scale build-to-rent investor, with an emphasis on the word "build", can work. We need to raise that awareness among policymakers and people of influence, who can set the agenda for the future and free the market.

Lord Sharkey: And the Ministry of Defence?

Mr Nick Jopling: It has a lot of land, but Otterburn is not in the right place.

Mr Chris Taylor: I like to refer to accessible rather than affordable housing. The key is accessibility. By definition, a lot of MoD land is inaccessible.

Mr Nick Jopling: The point David made earlier about transport and infrastructure was very relevant, as was his point about densification in town centres and around infrastructure points.

Lord Sharkey: If I understand you correctly, although you are very enthusiastic about it, there is no agreement about the possible scale of the development.

Mr Nick Jopling: No, I do not think there any numbers. The final bit of your question was about what could happen. I would like to see us match the 20% to 25% of people who are renters in the market. When we develop on public land, I would like us to be able to say that 20% to 25% should be built in that way on large-scale sites. It should not apply to small sites, where it is probably not relevant, because, if a housebuilder is building, the private investor can come in and buy to let on those markets. Where it is big scale, there should be a real necessity to provide that high-quality product and to fund and covenant it not to compete with the for sale product, so that we meet the supply issue.

The Chairman: What has changed over the last few years that has got us to this potentially rather attractive position?

Mr Nick Jopling: I am often asked that question. We are talking about creating an asset class. Chris works in that market more than I do; I work in a listed company environment. It probably takes 10 years to create an asset class. We are probably four to five years into that, because Montague was somehow the trigger point. It made a very small number of recommendations. It set up a PRS task force. It set up a fund to help construction, although it was not taken up fully, because the market started to absorb it. We started to make institutions aware of accessibility. There was no stock that they could go and buy. There are not blocks of 500 units for rent for the institutions to buy. That is what Chris would really like to buy, if they were there, but they all got broken up, dispersed and sold because of rent regulation in the 1970s and 1980s. The quickest way to turn the whole thing off is to have any form of rent regulation. If you whisper the words “rent capping”, you will turn this off tomorrow. Montague was the most significant thing.

There has been a general desire to do it. Last week, the Urban Land Institute published the second design guide on what these buildings should look like. Housebuilders said, “Are you telling us how to build blocks of flats?” No, we are telling you how to build blocks of flats for long-term rental—how you provide an environment and a community for people who can rent. It is not a second-class form of tenure. It is a perfectly rational, sensible and reasonable form of tenure for people of all generations to live in.

Mr Chris Taylor: It is a very good question. Another dimension comes from the Dutch—PGGM, in particular, which Nick knows well. The real estate market is global. We know that in London. We are seeing investors from overseas bringing new ideas, which has been a big change. I started off life at Prudential, which had huge residential estates. I will not go into why the Pru sold—that was another day. This time around it is different. Another important point is that the prospective returns from commercial real estate over the next five years—it comes back to data; there is an inflection point now—look to be lower than those from the residential sector, so there is an investment to be made. Clearly, institutions are looking for a return, but there is inflation-hedging and the prospective returns look relatively attractive.

Dr David Smith: It is important to bear in mind that, in a sense, the answer to your question is that nothing has changed, apart from the fact that there is an increased weight of institutional investment. Even if the size of institutional investment were to double, it would still leave over 60% of the sector in the hands of small private landlords. It comes back to the points that were made by Lord Forsyth and Lord Lamont. Why should the institutional sector get favourable tax treatment? Yes, it should be encouraged, but should it be encouraged at the expense of the smaller private sector? Inevitably, my argument would be no, because we need both, and we are in such a difficult position that we need both badly. If we encourage one at the expense of losing the other, we will deeply regret it in five years' time.

Lord Teverson: Could I explore one little thing? To me, one of the differences between the institutional and the small landlord sector is that, if the institutional sector is in for the long term, presumably you are not worried about going beyond shorthold leases, so families have greater guarantees that they can live there and will not be taken out. Is that your model—to avoid shorthold leases?

Mr Nick Jopling: Absolutely. I am at some pains not to disagree with David when he says things, but earlier he said something I did not agree with. In Barking, where we have provided a purpose-built rental building just for rent, we offered three-year tenancies to all our tenants; 40% of them took those tenancies. The important thing about what we, as Grainger, offer the market is that we offer that commitment for three years. We say to the tenant, "We understand that your circumstances might change—your relationships, your family, your job, your career or whatever. Therefore, after six months you can give 28 days' notice to us, but we will commit to you to provide that long-term tenancy". The one thing we do not want as a long-term landlord is a void. That is the one cost we can never recover. We can recover the repair of a lock, a door or a loo—whatever it is. We can collect the arrears if people do not pay their rent. The only thing we ask our tenants to do is to pay their rent and behave in the manner in which they would expect their next-door neighbour to behave to them. That is all. Those are the rules. As long as they accept that, we welcome them staying for a long time, and we accept that their circumstances might change. We have no problem with longer-term tenancies.

Mr Chris Taylor: My answer is exactly the same. Our interest is aligned with the individual or family staying for as long as they are happy to stay.

Dr David Smith: I do not think that small landlords have a particularly different interest. Small landlords want tenants to stay for a long time. We surveyed our members to check that. Over half of our members are perfectly happy to offer longer-term tenancies if they are asked for them. In fact, the average tenancy length in London, which probably has the shortest tenancy length, is about 18 months. Most tenants leave their property at the tenant's choice, not at the landlord's choice. Institutional investors have a different risk profile and are able to take bigger risks with individuals, because they have a larger number of properties to deal with, but small landlords are not averse to offering longer-term tenancies. The concern that smaller landlords have is that if tenants fall into rent arrears in particular it is difficult to get them out of the property, to recover possession and to continue to let to another tenant who will pay the rent. Unfortunately, the problem is at the door of the court system and regrettably the fact that arguably it is underfunded.

Q223 Lord Teverson: Thank you for that clarification, which is important. I should say that I rent one property on a shorthold lease.

As Baroness Wheatcroft tried to explore, we have found it difficult to understand why the institutional market will suddenly improve. Is finance a barrier? When you are going through the planning process, putting in the infrastructure and the school, and then building and, finally, getting a rent where the cash flow is probably paid back in year 12 or something, is finance a problem? You talked mainly about London. I take the Liverpool example, which is an important one, because Liverpool does not have the greatest of economies, but what about the rest of the world? Take my part of the country. Plymouth is a very low-rental area.

In rural areas such as Cornwall, there is still a huge shortage of housing, but very low rentals. Does your model work outside major metropolitan city centres?

Mr Chris Taylor: It does. The reason is that in London the net net yield will be less than 3%, whereas outside London there is a 31% leakage from gross to net and the net net yield is closer to 5%. Whether it is Plymouth, Leeds or Bristol, our model really works best outside London, partly because we can compete for land more readily. We find that it is easier to engage with local authorities, which are looking for regeneration in their city centres. It is a conduit for growth—all the factors I mentioned earlier. At the end of the day, they want to retain talent. Plymouth is a good example; I was born quite close to it. The challenge for a city like Plymouth is to attract and retain talent, because that is key for employment. In our view, all those things come together.

Dr David Smith: There is a gap in genuinely rural areas. With respect, this is where I do not think that institutional building can work. It is very much a restriction of planning. Rural rental is still substantially tied up with larger private landowners with historical land ownership. It is therefore very much covered by organisations like the Country Landowners' Association. It remains the case that many more rural tenants are on totally different tenancy agreements, usually with rent control, because they are historical tenants.

Lord Teverson: Finance is no barrier. You have a good proposition.

Mr Chris Taylor: The barrier is having to take the risk of building purpose-built, institutional-quality housing, because it does not exist in this country. As you mentioned, the barriers are in getting the planning, the site and the assembly. The finance is not the issue. It is there. That is the message that I would like to leave. The capital is there. It is about implementation.

Lord Teverson: It is about the asset class as well.

Mr Chris Taylor: Yes.

Mr Nick Jopling: I agree with parts of both comments. The challenge of really making it work—on a net operating basis, as Chris said—is scale. We can run a building of 150 units probably with the same staff as we can one of 120, so we would want to build 150. David is absolutely right to say that building that in a rural environment is challenged and it does not work for us there, but it does in regional cities—not just the principal regional cities, but those that have universities or levels of employment that mean there is a demand.

I go back to Aldershot, although I know it is near London. When we were doing our research around Aldershot, we found that the challenge for HR directors in Farnborough Business Park was how to attract people to come and work in Farnborough. People wanted to commute to the area from London or live in Guildford, but they did not want to live in Aldershot, because the quality of product was perceived not to be there and it was very much an Army garrison town. You can start to change things by place-making, with different mixtures of tenures. I mentioned the scale at which we are building in Aldershot. The answer to your question about the school and the infrastructure is that we are making our return on that by selling the land to the housebuilders, for them to build on and do their job, because they do that a lot better than we do. They can build for sale more cheaply than we can, so that is where we get a return for that piece. That leads into the issue of housebuilders land banking. In this particular case, by doing this and having a development partner that says, "Bloor here, Redrow there, Barratt there, Bellway here", you stop all that land banking. Effectively, you are saying, "We will be flogging the next site here, in 18 months' time. Get on and build that, and we will build something over here". Yes, it has to work on the metrics and it has to be a net operating income. That comes with scale and place-making opportunities.

Q224 Baroness Wheatcroft: I would like to ask Mr Taylor and Mr Jopling about the building techniques they will be employing. An awful lot of housebuilders seem to be building houses in the way they have always built them, which is not always ideal in this climate. How industrialised are you prepared to go?

Mr Chris Taylor: I would not say industrialised. If you take the Liverpool example, the difference from a typical housebuilder's approach is that we are thinking about the different needs of those who rent—the concierge facilities, the storage facilities and the fact that, if you have a two-bedroom unit, you probably want two bathrooms. Nick will have much better examples than I do, but a lot of it is around design, rather than thinking about materials. As it happens, we are using traditional materials. There are discussions about industrialising and in situ construction methodology. We are not pursuing that. We are using traditional materials.

Baroness Wheatcroft: If the aim is to deliver an increased supply quickly, might it be worth exploring that way of doing things?

Mr Nick Jopling: This is really starting to look into the future—at modular building, effectively. In fact, a team from Grainger went to Hull to look at a company that makes modular bathrooms and kitchens that you can literally put in. They can be built off-site, brought on lorries and put in much more quickly. We have not made a decision on that, but it is an area that we are starting to look at.

Chris is absolutely right: the design is essential, because of the net operating cost. Any of you who lease a flat in London or anywhere else knows that you have to pay a service charge, but there is no one paying our service charge. We have to pay that. We pay for the lifts, the cleaning, the concierge and the insurance for the building—all those factors—so we design them in to be as efficient as possible from day one. We therefore look to have materials that have durability—long-term life. We are not after fancy pipes, taps and showers or marble and things like that. That does not mean that we are building a second-class product. It is built to last, so the maintenance costs are down. The modular piece is being able to build faster—if we can put the bathroom plugs in, for example. We have been looking at how the student housing market did that. In some ways, what happened with the student market, and its growth over the last 20 years, is a real example of how the build-to-rent market can work. Effectively, it is a homogeneous product, so you can start to get economies of scale in the supply chain.

Q225 Baroness Wheatcroft: I have a quick question on the changes in the Budget, particularly on buy to let. Earlier you said that you thought that the effect would probably be marginal in the end. Is there anything more to be said on that?

Dr David Smith: We are very concerned about the change. We have looked at our members, who are telling us that they will simply stop investing in the sector. We do not believe that many of our members will sell properties to owner-occupiers; they will simply sit on them. Nothing will happen, which is the worst possible scenario. The sector will stultify, which is possibly the worst thing that could occur.

It is a problem for many of our members. Many people in the private rented sector are older. Most of my members are over 60 or over 65. That is a problem for us. As a membership association, we want younger members, but younger people are less inclined to invest now, because the environment is being made less attractive. It creates another problem, in that older members want to sell and leave the sector, to release money that, effectively, will be their pension money. It has now been made more difficult for them to do so. If they are going to sell, who will they sell to? It is not realistic to believe that many of them will be selling five-bedroom properties to first-time buyers, because there are not that many first-time buyers who want five-bed properties.

Baroness Wheatcroft: Do you think that the changes are sufficiently significant to stop newcomers entering the market?

Dr David Smith: No, I do not think they will stop newcomers entering the market, if the economics work for them. This is an area where the Treasury is still being incredibly coy, but it depends very much on the basis on which it will allow the 3% SDLT uplift to be waived. It has consulted on it, but it is being very cagey about what the basis will ultimately be. It depends very much on how the stamp duty land tax stuff shakes out. The mortgage interest relief is not as big a deal as a lot of people think, because not that many buy-to-let landlords have mortgages—far fewer than people think—and they are a lot less heavily mortgaged than they were traditionally. Many of those currently entering the market tend to have quite low mortgage borrowing, but the stamp duty land tax changes are a serious problem for them, because they cannot get in and they cannot get out.

Mr Nick Jopling: It is worth pointing out that there is no one in the institutional sector or, I think, the BPF sector calling for or supporting this. No one is saying that small landlords should be taxed an extra 3%.

Mr Chris Taylor: Quite the reverse. Our members in the BPF are looking for a holistic approach to the housing problem, which is sorely missing. The disappointment for the BPF is really to do with the lack of a holistic approach to the problem.

Mr Nick Jopling: As we were discussing earlier, the financials are so sensitive that, if you put that 3% on the bill to rent on the institutional side, we may as well forget it all. We must remember that that £30 billion or £50 billion—whatever it is—of institutional money has lots of places to invest. At the moment, it is looking at our sector and at helping to sort out our housing supply issue. We do not want to do anything to put it off. In fact, we want to encourage it to enter the market.

Q226 Lord Turnbull: In the first instance, I turn to David Smith. You mentioned countries overseas, which was a very good point. We are having a meeting with experts next week. You mentioned Germany. Can you give me the three-sentence version? You say the whole framework is completely different. What is it we should be looking for?

Dr David Smith: The first point is that as an economy Germany is different. It has more large cities, so there are more places. It does not have the UK's London-focused concept. It is a different economic model. Tenants do not enter property on the same basis; for example, they have their own cookers. In Germany, the norm is that you get nothing other than a bare property. You put in your own appliances, including your own white goods. When tenants leave a property, they have to pay the landlord money to help them find replacement tenants. The entire structure is totally different, and comparing Germany with England is quite difficult. Tenants have more security of tenure.

Lord Turnbull: But is there anything usable that you can go out and grab and bring here?

Mr Chris Taylor: Patrizia, which is one of Germany's largest institutional owners of private rented sector—has about €10 billion—it is the quality of management and the service provision. Patrizia has been doing it for 25 or 30 years. We have a lot to learn from best practice on how to provide real quality and value to tenants.

Dr David Smith: I would caution against the one thing you are trying to ask me to do, which is to grab one thing from Germany.

Lord Turnbull: Maybe the answer is that there is not something we can take, in which case we may not learn a lot from them next week.

Dr David Smith: I speak from having worked in Wales, particularly as a specialist adviser to the Welsh Government. Not everyone agrees with what they have done in Wales; the RLA did not wholly agree with their change in structure. They looked at all of it from square one. The whole point about the renting homes Bill—now the Renting Homes (Wales) Act—is that they started from scratch and attempted to recast the entire private rented sector, social, institutional and small private, into a new structure. The difficulty in England is that there is reluctance to do that. Lord Teverson referred to sticking plasters on sticking plasters when speaking to a previous evidence-giver. That is where we are. Some of the economic changes are still trying to tinker round the edges, and perhaps we need to stop trying to grab ideas from Germany and start again.

Q227 Lord Turnbull: You talk in a very upbeat way about what the sector can do in the future, as opposed to what it is doing now. If we are trying to increase the number of new homes built per year by 70,000, what contribution can the professional institutional investor in rented property make to a target of that kind?

Mr Chris Taylor: If my prognosis is right, which is that £50 billion or £60 billion of long-term institutional money would invest in new purpose-built private sector rented units and that equates to 400,000 or 500,000 new units over a period of, say, seven years, there would probably be 60,000 or 70,000 a year. That is a lot of ifs.

Lord Turnbull: Given the laws of physics, if you have a wall of water, which was the phrase you used, with that much money—£60 billion—how come it has not burst through and we are not seeing it?

Mr Chris Taylor: It is happening as we speak, but not on that scale. I think the number we estimate currently is 37,000.

Mr Nick Jopling: Of those, the best estimate is that there are about 20,000 in London. I cannot remember the exact figure for what is going through the planning pipeline. There are lots of issues: land assembly, planning issues and all the things we have touched on this afternoon. There is much debate. Whether it is listening to Lord Kerslake from the London Housing Commission yesterday, the Urban Land Institute on Friday at the Royal Geographical Society, the announcement of the publication of a second book at the British Property Federation, or build to rent committees, all of us in the sector spend our lives trying to do everything we can to open the taps. We are really trying to get the public sector to engage as well.

Lord Turnbull: Who is keeping the taps closed at the moment? Where is the blockage?

Dr David Smith: Nick touched on that a little earlier. One of the problems is that that investment is looking at our sector, but it is also looking at a lot of other sectors, some of which are not in this country at all and some of which have nothing to do with housing. We might or we might not attract institutional investment, but the real danger is that it might be attracted for a bit and then go away again, because France does something that is more attractive.

Lord Turnbull: You are also implying that in this covenant there is some kind of deal or discount. Someone is not getting as much value for something as they otherwise would, to benefit your sector. I have not grasped how it works. Is it that you get planning permission but the current owner of the land has to make do with a lower price than they would otherwise have got?

Mr Chris Taylor: That is a good question. It comes back to having a holistic approach. A lot of education is required on the need to provide choice and a balanced solution to the housing problem. It comes back to local planning. For example, Manchester had the vision and foresight to recognise that it needed to designate certain sites for the private rented sector to have a balanced answer to the housing problem. It is not perfect, but it has identified sites that are now being built. We are building Pomona Wharf opposite the Trafford Centre. Right now 276 units are being built, and there are another dozen sites in Manchester that the city has identified and zoned specifically for the private rented sector. It is the covenant—

Lord Turnbull: That influences the price at which you can access the land.

Mr Chris Taylor: Yes, it does.

Lord Turnbull: Presumably, under Section 106, when you are bringing in families, the social provision is the same whether they are renting or buying. You are still subject to Section 106.

Mr Chris Taylor: Yes.

Mr Nick Jopling: You are asking about my favourite subject. I sat on the Montague Review. If I have one message to get across, it is about the strengthening of that covenant. If you are a local authority, it is a covenant from me to you to build on your land to provide housing stock that is required and that you have identified. My covenant to you is that I will rent in those bandwidths, or the proportions we all talked about earlier, for a period of time. If I break that covenant, there is recourse and a clawback to you. First, you are protected; secondly, I am protected if there is value-damaging legislation in future, such as rent capping or whatever, and as an institution I suddenly get scared by that, which happened last time around. It happened in the cycle 30 or 40 years ago, and that is why we do not have an institutional private rented sector today. We had one and we threw it away. As an institution, I can break that covenant, but there is a price to pay; I have to pay it back. That is probably Section 106. I provide a third covenant to the tenant, because if I give you a covenant for 15 years there is no reason why I would not give a longer-term tenancy.

Lord Turnbull: It starts with local authority-owned land.

Mr Nick Jopling: Yes.

Lord Turnbull: How does that model work when you are trying to develop it on what is currently privately owned land?

Mr Nick Jopling: I have given you an example of what we are doing on privately owned land where we have chosen to do that. People say, "Why are they doing that?" They are delivering something of lower value at Portsmouth, if you remember, where we are building alongside. That site will take 15 to 20 years to build at one a week. If we as a private landlord can deliver that development in 12 or 15 years—we are talking about public land—we are delivering a quantum quicker, and so the internal rate of return on that land for that model means I can make it worth while.

In the circumstances of Kensington and Chelsea, we work with them. They take a net income off the deal we have done with them with a 125-year lease. We are building now.

Lord Turnbull: That goes back to land that K and C own.

Mr Nick Jopling: Yes, so I am going back to public land.

Lord Turnbull: I see how it works there. I still do not quite see how you get it to work with private land where the owner would rather sell it to a housebuilder.

Mr Nick Jopling: The only time it works is on a large scale. Big sites of 2,500 units will take 15 years to deliver. If you can deliver them faster, in 11 or 12 years, the rate of return on the money you have invested is higher than or equal to the amount you would have if you had waited and perhaps taken the risk of going through a cycle with house prices falling and delaying it, not for 15 years, but 16 or 17 years. The institutions and landowners put that pricing into the risk. We are into a land-pricing risk model, which is probably another discussion.

Lord Turnbull: Your argument is that you can bring in tenants quicker than they can bring in buyers.

Mr Nick Jopling: Absolutely.

Mr Chris Taylor: Your question is key. There are lots of sites we have missed out on, in Nottingham and in Leeds, because we have not been able to compete with the traditional builder.

Lord Turnbull: I want to know what has gone wrong at Battersea, but you might tell me afterwards.

Q228 Lord Forsyth of Drumlean: In my small brain, I summarise it as follows: it works because the local authority provides the land at less than actual value, and it is giving you a discount; and in the case of the private sector, it gets the cash upfront and you discount the value accordingly. Is that the model?

Mr Nick Jopling: We are into a land debate. Effectively, you are right. They are equalising one or the other.

Lord Forsyth of Drumlean: You are in a position to do that because you have bags of cash.

Mr Chris Taylor: It is a long-term investment.

Mr Nick Jopling: We are long-term investors.

Lord Forsyth of Drumlean: I put it more pejoratively.

Mr Nick Jopling: This is important for the local authority bit. A lot of local authorities want to enhance their revenue receipts rather than their capital receipts. If they can create a long-term partnership, where their land, effectively, is part of the delivery of the build-to-rent product and they take an income stream off it for many years, that suits local authorities. No two sites are the same, as I think somebody said earlier. There is individuality in everything. Every city, every part of London and every rural and regional area should be looked at individually, but there is usually a solution.

The Chairman: Would it be correct to say that the lower than market rents that you covenant to charge on certain properties represent part and parcel of Section 106?

Mr Nick Jopling: They can, and they can provide affordable housing, but with a small "a". We are back to my stepping stones.

The Chairman: Would social housing be part of that mix as well?

Mr Nick Jopling: In the case of Grainger, because we have a registered provider within the group, we can do that and we are doing it, but remember our single building with one operator and one owner. If Chris has to put in social housing and he is not a registered provider, he has to bring in someone else. That starts to make his model very complicated and it does not work. It probably has to be in a different building, and then we start talking about poor doors and segregation. There is an element where the most desirable thing is to say to the institutional sector that each site is treated individually, and to make that land worth while it is all private rented and the social housing is dealt with elsewhere on the site or on an offsite payment. Equally, the for-sale property is dealt with in that way, or there may be no for sale on the particular site. You put in those stepping stones depending on what the landowner wants to do. There are lots of examples. It is probably too much detail to go into now.

The Chairman: To go back to Lord Turnbull's taps, how do you turn on the taps faster? What single initiative or policy change would result in the taps turning on faster so that the money that is at present waiting to go into this sector does not disappear overseas?

Mr Nick Jopling: Public land is key. There should be awareness and strengthening of the covenant to be used by local authorities, and increased awareness among planning officers to say, "We can do this on our car park sites or above our supermarkets and bus stations". It does not have to be an MoD or TfL site; it can be above a car park or supermarket in a town centre. Use the covenant to get what the local authority wants for its housing needs.

Mr Chris Taylor: For me it is the same. It is working in partnership with the public sector, and the covenant will enable us to compete.

Dr David Smith: We do not need the taps to be turned back on. We were doing it already. All we require is that the tax system is not changed to turn them off.

The Chairman: On that very positive note, thank you very much. It is very good to have a session that ends with some solutions rather than problems. Thank you very much indeed.