

Why The Big Boys Do Not Invest in Residential Property

Many of the large Institutional investors, for example, insurance companies, property and pension funds, banks etc would love to invest in residential property but only a few are doing it and only to a limited extent. For example, some of the lenders are competing with their clients by quietly buying up below market value properties and large blocks of residential flats.

All investors have to be confident that what they are going to invest in is going to perform and it is by no means universally accepted that residential property will perform or more importantly perform as well as or better than say commercial property. Some large investors refuse to deal with residential as they prefer the strong consistent yields they get from letting to a blue chip company for a long period yet other lenders say if they own 5000 terraced houses this gives a more consistent yield. However, those large investors who do see a future in residential property have three major problems with residential property:

(1) Unit size

The first is the unit size is not large enough, where residential investors talk in hundreds of thousands of pounds commercial investors talk in millions of pounds. The minimum investment they make is around £100million – where can you buy residential property in blocks of hundreds of millions of pounds? But watch this space, I know of a landlord who has £500m of residential property who is being approached by investors who want to buy the whole portfolio.

(2) Disrepair

However, the main reason large investors are reluctant to invest is the prejudicial nature of the legislation against landlords in the disrepair and tenure area. No large institution will want to be associated with owning property where they are prosecuted for disrepair and accused of being a slum landlord. A tenant can move into a perfectly satisfactory property and wreck it. Usually it is the children who do the damage but adults can do very nicely as well.

I currently have a single mother who moved into a lovely house, I know it was lovely because my manager lived in it and while doing so improved it at my expense and obviously it goes without saying no expense was spared. The new occupier decided she would redecorate so pulled up the perfectly good carpets and threw them out. Ripped the wallpaper off the wall and great chunks of plaster at the same time. The house is eighty years old and the plaster is soft or loose in places. The ground floor doors were pulled off and burnt. Her son smashed through a boarded up doorway from the lounge leaving a gapping hole in the wall. The front of the gas fire was smashed leading to the Gas Board condemning the gas supply to the property so leaving her without any heating. She failed to unblock the outside drain when it got covered in leaves so it flooded and caused damp

and other problems. I could go on. Imagine what the property would now look like to the Local Authority Housing Standards Inspector and how could you explain, you as the landlord were not to blame! I can give countless other examples. Commercial investors want nothing to do with that kind of problem. Such investors look at commercial property where all the repairs are the responsibility of the tenant, you cannot do that with residential property.

With repairs, as far as the strict interpretation of the law goes it does not matter who caused the damage to the property, it is the landlord who is responsible and if the property is unfit, the local authority can prosecute the landlord for letting an unfit house, it is not a defense to say the tenant caused it. Most Housing Standards Officers are well aware of the situation, they see it everyday with their own or what was their own council house tenants, as most Local Authorities have transferred their properties to housing trusts. As one recently said to me, wearily shaking his head, 'Don't bother to explain Jim, I can guess what has happened!' The tenant's son had ripped the lead off the roof which resulted in damp in the house with associated mould growth – but here comes the rub, 'You, Jim have to fix it!' If I refused and I can understand some landlords who, perhaps, not accepting that it is all part of being a landlords lot would refuse. I wonder if they also refuse to take the tidy capital appreciation the property had made! Or, if I have been dealing with some zealot, there are a lot of people who work for local authorities who, come the revolution, would have every landlord shot, who perhaps wanted to make a name for themselves may have tried to prosecute me.

With the house with the damp I got on with the tenant quite well and asked her what was going on and why she had involved the Housing Standards department. She was quite open about it, she said she did not like the house and she wanted a council house. One of the ways of getting a better chance of being re-housed was to complain of the unsatisfactory condition of her current accommodation.

I have had it before, once a tenant gets it into their head that a council or social housing is better you cannot persuade them otherwise. Sometimes it is that they can be with their friends or family, otherwise it is because they believe they will get a new house and have no 'top up rent to pay'. With Council and Social Housing, Housing Benefit pay all the rent, there is no 'top up' payment to make. Many tenants do not appreciate that some of the worst housing is in the social sector and social housing has the worst record on repairs. Anti social behavior is rife in some areas. This is one of the best kept secrets in the housing world. The press and tenant groups go on about private landlords and Rackman's while ignoring the appalling state of some of our social housing. I have had tenants asking to come back after being re-housed but most I don't hear from them again, I suspect

due to the fact they burnt their boats with me not because they are happy with their new accommodation.

If the tenant is not paying a 'top up' it only makes sense for a private tenant to move to the social sector when they are working and paying their own rent. Rents for houses and flats in the social sector are about two thirds those in the private sector, partly due to the enormous subsidies the social sector receives. I have families who are paying me £120 a week while in the social sector they would only be paying about £90 per week. Strangely, the reverse applies with HMO tenants. In the social sector hostels, foyers etc the rents are about ten times higher than I charge but these tenants are always unemployed and the state pays.

Getting back to my damp problem I decided retreat was the better side of valor, even if I did the repair I am sure her son, who by this time was becoming a nuisance in the neighborhood, the tenant could not control him, would continue to damage the property. The Local Authority did not want to re-house her where she wanted to live so would continually be demanding I repaired the damage caused by her son. My option was to evict or sell. I sold the property in auction. Let that be a lesson about buying property at auction!

Interestingly, the government is considering legislation to prevent landlords evicting tenants who complain about disrepair. In this business problems are always seen from the tenants side. You can see why the big institutions are understandably very nervous about investing in residential property.

(3) Eviction

The final problem is what can be the very difficult process of evicting tenants. There are two main ways of evicting tenants. The first is to use one of the grounds under Section 8, usually rent arrears but with a clever lawyer the tenant can run rings around the system so making it almost impossible to evict the tenant on Section 8 grounds. The other ground is Section 21, with two months notice after the expiry of the term of the tenancy, usually six months.

There should be no defense to this, as long as the paperwork is correct and you have a written tenancy agreement the court must give possession to the landlord and evict the tenant. All the housing pressure groups are very anti the Section 21 ground and there is continual mutterings about repealing the Section 21 ground.

Commercial investors want to be able to evict an unsatisfactory tenant and have no confidence in the government. You need to remember that the labour government after the war destroyed the private rented sector by introducing rent controls and investors who remember this and who are aware of how the present government think, are nervous. If the tenant fails to pay the rent on a commercial property the owner can seize the tenants goods to pay the rent and change the locks and

refuse to let the tenant back unless they pay the rent arrears and if they don't re-let the property. You would be sent to prison if you tried this with residential property.

However, as I said earlier a few brave souls in the investment world have started to buy and if confidence increases I think it will lead to a change. Once big investors start investing in residential property, I believe the buy to let scene will change, probably forever.

Wide scale institutional investment is already happening in the student let market and it is having two effects, one the standard of property is increasing but variety is being lost. The other and more significant is that yields are reducing. In the student let market gross yields are now as low as 5.5%. I generally will not buy a property to use as a HMO unless I gross 20% and I find I lose money at below 12% gross yield, *(NB yield is calculated by dividing the gross rent by purchase price plus all costs and multiplying by 100. For example, gross rent £20,800pa. Purchase price £90k plus renovation and purchase costs of £15k. Total cost £105k gross yield 20,800 / £105,000 x 100 = 19.8% yield)*

Institutional investors with their own money, deep pockets and a long term investment strategy can afford to fund low yielding investments, providing the capital appreciation remains good. Private investors who have to borrow money to invest will be unable to compete. If the institutions do start to seriously invest in residential property then it is going to make life very much harder for the new private investor. For the existing investors they will see their property prices increase as yields decrease especially in the HMO market.

Will I stop buying HMO's when I can no longer get yields of 20%?

Probably! I do not, though, believe the yields once they decrease will ever go back to the current level so I suppose my philosophy should be to buy as much as I can now and hope for the change into this sector by the commercial property investor.