

UK Rural - September 2023

Q
SPOTLIGHT
Savills Research

The future of rural homes



Tenancy reform • Energy efficiency • Rent vs repairs

10.3%

increase in rent for new tenancies compared to 4.8% at rent review for existing tenancies

16%

increase in no fault evictions over the last 12 months

4.4 years

average length of term for a residential tenant

Tenancy reform, energy efficiency requirements and inflationary pressures. The private rental sector faces a triple threat of challenges over the coming months and years.

These three challenges have implications for landlords and tenants and are likely to be compounded by the cost-of-living crisis, increased rents and the high cost of borrowing. The supply of available rental stock is tight and ever-growing demand is leading to a highly competitive market for tenants, while landlords are facing higher energy efficiency standards and an overhaul of their ability to gain possession from a tenant.

Estates will need to evaluate the impact of these three challenges and thoroughly review their portfolio strategies, both to endure the short-term transition and prosper in the long term.

Rural communities already face a “rural premium” due to the additional cost-of-living burdens, which become more pronounced during an economic crisis.



Managing residential portfolios

What impact will the Renters Reform Bill have on the management of residential tenancies?

The Renters Reform Bill is the biggest change in residential tenancy legislation in England since the Housing Act 1988. Section 21 will be removed and with it the ability for a landlord to serve a no-fault notice to recover possession at the end of a fixed term tenancy. Rural estates need to carefully consider how to manage their portfolios once tenants have increased security. Under the amendments to Section 8 of the Bill, possession may still be gained on specific grounds that cater for many portfolio management scenarios. However, there has been a knee-jerk reaction among some landlords as Ministry of Justice statistics show a 16% increase in “no-fault” eviction court proceedings between Q1 2022 and Q1 2023; an approach that risks reputational damage.

CHANGES TO SECTION 8 GROUNDS

■ **Rent arrears** The reform means eviction will become mandatory if a tenant has been in arrears for at least two months three times within the previous three years regardless of the arrears balance at the time of the hearing. This change provides landlords with a remedy against tenants who are persistently in arrears while ensuring tenants cannot be evicted based on one-off financial shocks that occur years apart. The court process for dealing with this will also be reformed to protect both parties. Estates should continue to focus on

the collection of rent arrears, with effective long-term record-keeping essential if use of this ground becomes necessary.

■ **Owner occupation** Landlords can secure possession where they intend to sell or they (or a close family member) intend to occupy the property. While these grounds cannot be used within the first six months of the tenancy, it means that there is flexibility to provide for a member of the family or to raise capital through a sale.

TERMINATION BY TENANT

Tenants will need to serve two months’ notice to terminate a tenancy. With proactive management and pre-planning of remedial works, landlords will therefore be able to better minimise void periods. As well as a loss of rental income, voids require landlords to cover expenses ordinarily covered by tenants, such as council tax and utilities. Extended void periods reflect an increase in statutory compliance requirements and investment in energy efficiency improvements, which are easier for landlords to undertake when a property is empty.

THE END OF THE AST

Fixed term assured shorthold tenancies (ASTs) will be abolished and replaced by periodic assured tenancies. These have an

WHAT ARE THE GROUNDS FOR POSSESSION?

Section 8 of the Renters Reform Bill contains 17 grounds for possession, eight of which are mandatory including:

- Owner occupation
- Sale
- Redevelopment
- Persistent rent arrears

The other nine grounds are discretionary, leaving a judge to consider whether it is reasonable. These include:

- Provision of alternative accommodation
- Tenant damage
- Tenant causing nuisance

“The importance of creating and maintaining a positive relationship with tenants has never been greater, to ensure that good tenants are retained”

undefined term and end either by the tenant giving two months’ notice or by the landlord serving a valid Section 8 notice.

What will this mean for landlords? Where previously it was known that a property would be occupied for at least the full term of an AST, this change will result in greater flexibility for tenants in choosing when to vacate and means landlords should stay fully engaged with their tenants to best predict the timing of vacant possession.

TENANCY LENGTHS

Private renters are occupying properties for longer compared to a decade ago. In 2021-22, the average was 4.4 years, compared with 3.8 years in 2011-12. Tenancies could lengthen further if the supply in the rental market continues to contract, as it is likely to be cheaper for a tenant to stay rather than take on a new tenancy. Our analysis of rural estate rent in the 12 months up to April 2023 shows that rents reviewed on existing tenancies rose by less than half of the increase achieved when letting a property on the open market.

MARKET RENTS

There will be a greater onus on landlords to prove that proposed rents are a true reflection of the open market. Landlords will also be required to serve a formal notice to increase rents and can only do so once a year. While this means an extra administrative task, the introduction of a formal process with the backing of the tribunal gives landlords the potential to keep rents in line with the market in the knowledge that they can rely on the tribunal to arbitrate should a tenant contest it.

In a further attempt to make rented homes more permanent, tenants will be given the legal right to request to keep a pet within the property, which landlords can only reasonably refuse.

REFLECTIONS FROM SCOTLAND AND WALES

Similar changes were made in Scotland in 2017 where a new private residential tenancy was introduced via the Private Housing (Tenancies) (Scotland) Act 2016. This created open-ended tenancies, removed the “no-fault” route to possession, requiring a landlord to specify one of 18 eviction grounds and stipulated annual rent reviews. In Wales, the “no-fault” route was changed in 2022 to increase the notice period from two to six months.

In England the reformed clauses will apply retrospectively to all tenancies, whereas Scotland imposed them solely on newly created tenancies.

Mark Fogden of Savills Estate Management in Scotland, says “the removal of no-fault ground hasn’t made any difference as there have and will continue to be challenges with some tenants.” Mark reflects that there is always a natural churn of tenants, but investing time at the start to find the right tenants is key,

rather than just relying on a mechanical referencing process.

The Scotland estate management team notes that as higher standards have been applied to the private rented sector, residential tenants are becoming more informed and their expectations are greater. However, these expectations are not necessarily matched with correspondingly higher rents.

GOVERNMENT SUPPORT

The reform will require landlords to use a new online property portal via gov.uk, which is designed to ensure the required standards for renting are clear to all parties and that compliance can be recorded. On 1 August 2023, the government launched a scheme to support tenants facing eviction or repossession in England and Wales. They will be able to receive free expert legal advice, helping them to keep their homes and avoid lengthy, costly court proceedings.

TIMESCALE

The Renters Reform Bill is currently awaiting its second reading in parliament and MPs have debated whether more stringent rent controls should be introduced, this is a route that has been taken in Scotland and is currently subject to legal challenge.

Once the Bill has received Royal Assent, an improved court process will be deployed. The changes will then be applied to all new tenancies six months later and to all existing tenancies a further 12 months after that. This gives landlords some time to consider the impact of these changes upon their portfolios. However, experience in Scotland, confirms that effective administration and investment in finding the right tenant at the start of the process should mean that the changes can be absorbed with limited disruption.

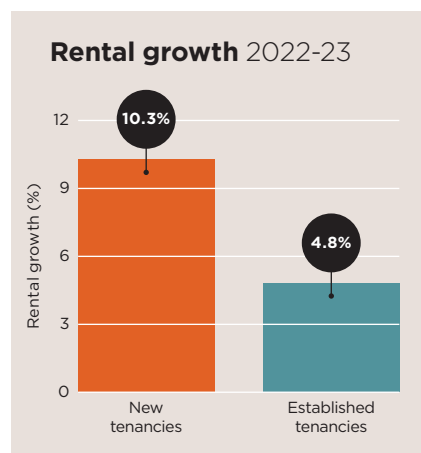


figure 1

Source Savills Research

HOW SHOULD ESTATES PREPARE FOR THE CHANGES?

Attention to detail, accurate record-keeping and smart tenant selection are crucial to ensuring that tenancies are effectively managed under the reforms:

- Smart tenant selection will be crucial.
- Diarise annual rent reviews and keep rents aligned with market levels.
- Declare and clearly record concessionary rents.

- Keep up to date with arrears and set flags for when arrears meet the grounds for possession.
- Fully specify and correctly administer Section 8 grounds for possession.
- To effectively manage expectations, inform tenants at the start of the tenancy if the landlord might in future wish to regain possession under the mandatory “prior notice grounds”.
- Use the newly created online property portal via gov.uk to record all tenancies.



SOCIETAL BENEFIT

Providing good quality, safe homes is a moral obligation for landlords but how legislated improvements are to be funded is a challenge. Some rural estates choose to accept concessionary rents in the case of long-standing tenants who are seen to provide an important contribution to the community and this may be extended due to the cost-of-living crisis. They absorb the rent foregone or what some will see as a subsidy in return for societal gain, which, for those who choose to measure it, will help them meet their Environmental Social and Governance objectives.

“There is a strong argument for landlords developing an energy efficiency strategy focused on the big picture of net zero rather than the next EPC target”

Energy efficiency: an uncertain certainty

Minimum Energy Efficiency Standards will be a moving target. How can landlords remain compliant in the long term?

Improving the energy efficiency of homes is a national priority, it is essential for the UK to achieve net zero homes because 17% of UK emissions come from residential property. To cut the carbon footprint of the private rented sector in England and Wales, a September 2020 consultation proposed amending the Minimum Energy Efficiency Standard (MEES) regulations to raise the minimum Energy Performance Certificate (EPC) level required to band C for new tenancies from 2025 and for all tenancies from 2028. Alongside this the amount landlords are obliged to spend before qualifying for an exemption would increase from a cost cap of £3,500 per property to £10,000 per property. A significant increase for landlords to sustain particularly if the expenditure has to be repeated each time the EPC target is lifted or an exemption expires. Change is also planned for Scotland where the government is aiming to introduce regulations in 2025 that would mirror the targets and timeframe proposed for England and Wales.

Adoption of these proposals in England and Wales had become the working assumption but as time passes the proposed timescales have become increasingly implausible. Since the consultation the government has not

formally confirmed its policy intentions but in a recent interview on BBC Radio 4's Today programme Michael Gove, the secretary of state for levelling up, housing and communities, suggested the proposals will be revised and implementation delayed. In parliament the government has committed to respond to the 2020 consultation before the end of 2023, but implied this would simply summarise the responses rather than announce its policy intentions. Our understanding is that the Department for Energy Security and Net Zero has indicated the first implementation date will no longer be 2025 and that the EPC assessment process itself will be reviewed, but there has been no formal announcement to this effect.

WHAT ACTION SHOULD LANDLORDS TAKE?

While the milestones may be uncertain, landlords can be certain that energy efficiency will be a policy priority. The Labour Party has stated its policies will include a National Warm Homes Plan to upgrade all homes to EPC band C within a decade.

Knowing the compliance baseline will continue to rise, there is a strong argument for

landlords developing an energy efficiency strategy focused on the big picture rather than the next EPC target. Many have set their own net zero objectives and merely complying with the MEES regulations will not meet these nor achieve them in the most cost-effective way possible. By analysing and modelling their portfolios strategically landlords can ensure both compliance with MEES and progress towards achieving net zero.

The EPC can make impractical suggestions or steer short-term thinking because it takes a general approach to all property. These weaknesses have been acknowledged, and a new consultation in Scotland seeks to reform domestic and non-domestic EPCs to increase the importance placed on the building fabric and carbon emissions of the heating source. At present an EPC will always suggest boiler upgrades using a like-for-like fuel source whereas a net zero focused energy efficiency strategy would review the suitability of alternative heating technologies to minimise carbon emissions going forwards.

Given substantial capital investment is likely to be required, landlords will want to ensure that their investment delivers against multiple objectives. As well as compliance and cost efficiency, elements such as heat security, environmental performance and quality of life for tenants can be built into the energy efficiency strategy to ensure investment is well targeted.

CREATING AN ENERGY EFFICIENCY STRATEGY

1 Assess
A building surveyor's assessment provides a more comprehensive appraisal of a building than an EPC, which is based on limited observations, assumptions and measurements. A building surveyor will conduct more invasive investigations to establish the property's true condition and capacity for appropriate upgrades. Where an EPC assessment may make a cavity wall insulation recommendation, a building survey could determine a wall's external face is not watertight, making such insulation unsuitable and potentially problematic.

Taking a more detailed and holistic approach means other objectives can also be



£32k

average cost of improvements for Diocese of Truro properties

96%

proportion of diocese properties that will have solar PV installed by 2030

2023

All Church of England dioceses required to have retrofitting plans in place by the end of this year

met. For example, health and safety upgrades identified or a preventative maintenance programme developed to plan and manage expenditure. While this may add time and cost, the process is more efficient overall and can provide a thorough understanding of each building and its potential within a portfolio.

2 Analyse

The information gathered can then be analysed and multiple scenarios developed. Typically three are put forward:

■ **Compliance** The necessary base measures to make the property legally lettable. As well as minimum energy efficiency standards, other factors such as health and safety and property condition can be reported.

■ **Best achievable** What is the realistic best case scenario? Crucially, these recommendations are based on the building surveyor's property-specific assessment.

■ **Recommended** A balanced approach incorporating budget, the value of the asset and the individual objectives of the landlord. It also considers the significance of the building – for example, is it a heritage or core property?

Compliance is essential in all scenarios, so once a decision is made the Standard Assessment Procedure is conducted to understand what EPC rating would be achieved.

3 Combine

Conducting an assessment of all properties in a portfolio provides an initial, estate-wide benchmark to establish the current position, overall recommended actions and the ultimate potential of the portfolio, including potential emissions savings, EPC ratings, percentage improvement and the estimated costs to achieve the target. Beyond this, it is possible to calculate how much carbon offsetting may be needed to achieve net zero if that is the overall goal.

Collating all this information in one place allows scenarios to be modelled and the impact on compliance levels, energy costs, greenhouse gas emissions and investment requirements to be understood.

4 Comply

MEES compliance must nonetheless be addressed. A professional energy assessor who is aware of the nuances of different properties can be invaluable. Providing the acquired knowledge to that assessor can help ensure that EPCs are informed by evidence and fewer assumptions. If achieving the EPC target is not possible in the short or longer term, exemptions may be available, supported by evidence gathered during the portfolio review.



FUTURE-PROOFING RURAL HOMES

The Church of England has committed to achieve net zero carbon by 2030 and must address emissions from buildings as part of its strategy. By the end of 2023, all dioceses are required to have retrofitting and maintenance plans in place and to have commissioned stock surveys such as EPC Plus reports for clergy housing. By 2024, all will have stock improvement plans in place.

The Diocese of Truro intends to bring as many

retained properties up to EPC band A as possible, while upgrading all others to a high standard where this is not possible.

Following an enhanced EPC process, two-thirds of its property is expected to achieve band A and all but a small proportion of the remainder will achieve band B. When initial assessments were conducted, two-thirds of the retained properties sat at band D or below, marking a vast improvement in energy efficiency that is far beyond current compliance requirements but essential for its longer-term goal.

On average, upgrades

will cost in excess of £32,000 per property, with the investment in some costing up to £75,000. Yet this will see 96% of properties equipped with solar photovoltaics and 61% fitted with air source heat pumps. In addition to compliance, the approach is designed to create heat security, with wood burners also being installed in certain cases, and significant reductions in greenhouse gas emissions. Front-loading capital investment futureproofs the portfolio, allowing the retention of a valuable and resilient asset for the long term.

How the EPC profile of clergy housing is expected to change over time as upgrades are installed across the residential portfolio

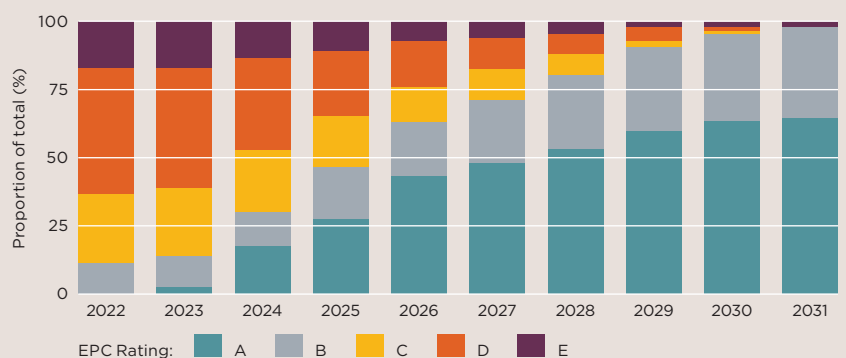


figure 2

Source Diocese of Truro, Savills Research

28%

proportion of rural estates' income from residential rents in 2023

£1,664

highest average rural residential rent per calendar month is found in Oxfordshire

92%

increase in expenditure on repairs to rural homes since 2021

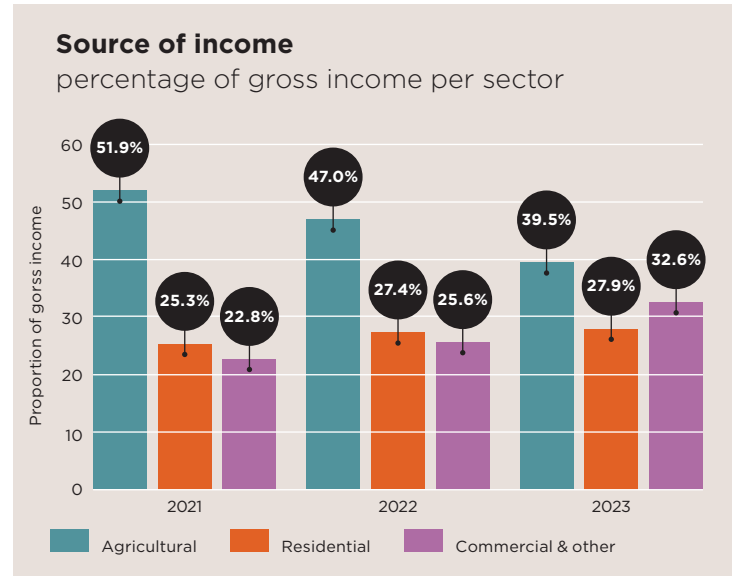


figure 3

Source Savills Research

The race between rental growth and increased expenditure

We look at the effects this is having on the rental market and its demographics

The growing regulatory burden on property may cause some estate owners to question the value of their retention. Analysis shows income from rural homes provides over a quarter of the total income received by rural estates and that residential income has grown along with commercial as a proportion of the whole, with agricultural income having declined by 12% in only three years.

Rents for all types of residential property have grown over the last 12 months, with larger properties generally achieving the highest growth rates. UK annual rent increases set a new record for the 12 consecutive months up to April this year according to Office for National Statistics data going back to 2016. While the pace of annual rental growth appears to be slowing, the affordability of rents remains a key issue with tenants facing multiple cost-of-living pressures.

Since 2021, the average private rented rural tenancy (excluding regulated tenancies) in Scotland increased by 2.3% to £590 per calendar month, while the equivalent assured shorthold tenancy (AST) rent for England increased by 2.2% to £929 per calendar month. Regulated tenancies rents saw slower growth across both nations, averaging a 1% increase to £465 per calendar month in Scotland and 2% to £589 in England (figure 5).

Looking in more detail into how different

sized house have performed, the largest houses have seen the biggest rental growth over the last two years (figure 6).

GEOGRAPHICAL RENTS

Specifically looking at performance within the English counties, the highest rural residential rents (across all tenancy types) have consistently been in Oxfordshire, which has an average rent of £1,663 per calendar month and shows rental growth of 8% since 2021, which is above the average for England.

For Scotland, the highest rents are being

achieved in Fife, with an average rent of £691 per calendar month and rents have grown by 4% since 2021.

EXPENDITURE

Repair costs have unsurprisingly risen significantly and faster than other costs, with a 62% increase over the last 12 months while total expenditure has increased by 35%.

The near doubling in repair expenditure (figure 4) reflects increases in materials and labour. It is worth noting that repair expenditure in 2021 will have been reduced by the Covid effect, hence the ensuing elevation in net revenue returns. An increase in statutory compliance and investment into energy efficiency measures are other explanatory factors. All elements of expenditure have grown over the last 24 months, increasing as a percentage of gross income from 35% in 2021 to 41% in 2023. Even so, repairs are of greatest concern, having increased the most.

NET POSITION

Savills financial reporting shows growth in rents across all residential sectors in the UK, but also substantial growth in expenditure. Therefore the key question is what impact has this had on net income. In 2023 net income decreased to 59% down from the header heights of 65% in the years of 2021/22 (figure 7).

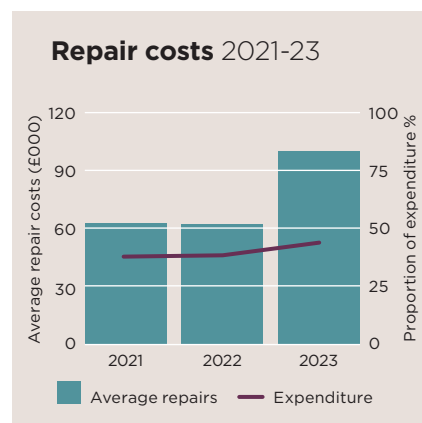
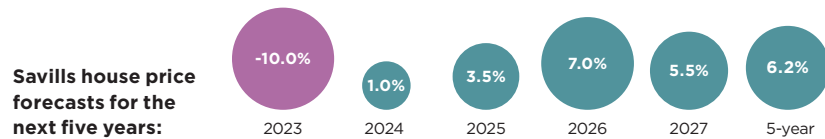


figure 4

Source Savills Research



THE CHANGING DEMOGRAPHIC OF THE RENTAL MARKET

A combination of the impact of the Renters (Reform) Bill, increased energy efficiency requirements and increased mortgage and occupational costs are likely to curtail investment in the private rented sector, and lead to large-scale exits by those operating a “Buy-to-Let” investment model. Over the last five years, over 250,000 more Buy-to-Let properties have been sold than purchased.

Recent analysis by Savills Residential Research suggests that in the first quarter of 2023 (prior to the recent rise in mortgage rates) the average net profit for a 40% taxpayer buying with a 70% loan to value mortgage had fallen to below 4% of the gross rent received. That is the lowest margin since 2007 and well below the 23% seen between 2014 and 2017 and has been compounded by restricted tax relief on mortgage interest. Overall, this is likely to mean a continued undersupply of homes for rent and continued upward pressure on rental values. However, Savills analysis suggests that only 2.64 million of the 5.69 million homes in the private rented sector carry a mortgage and thus the impact may be more buffered than previously forecast.

Lucian Cook, Head of Savills Residential Research, considers how the sector will change in the longer term: “For landlords, the market will increasingly favour cash buyers or those with plenty of equity in their properties or who hold lower levels of debt. For tenants, the loss of the Section 21 notice, risks problems for lower-income households seeking rental accommodation. Ultimately landlords will simply go with more affluent tenants who they feel offer greater security over the long term in terms of rent payments. Married with a reduction in rental stock and the challenge of affordability, difficulties fall on those in lower socio-economic groups.”

Average residential rental income split by tenancy type

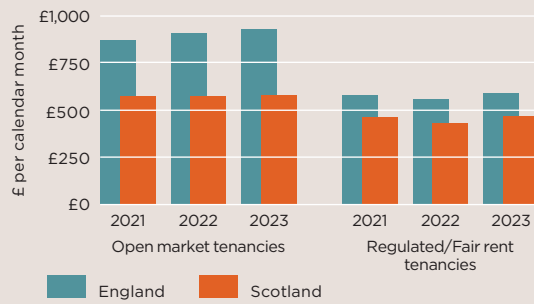


figure 5

Source Savills Research

Average residential rental income by property size (all tenancy types)

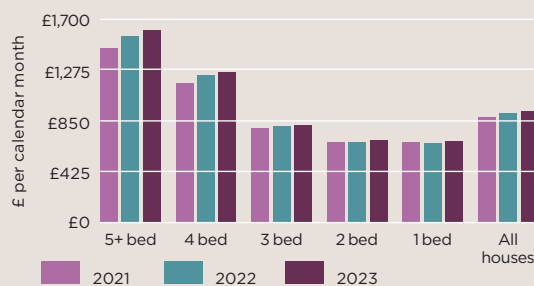


figure 6

Source Savills Research

Income vs expenditure

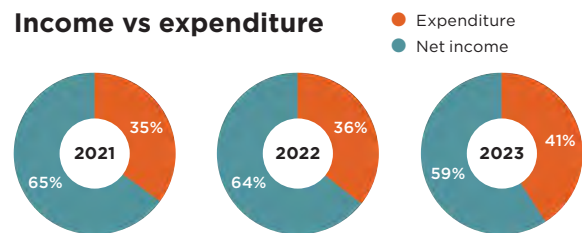


figure 7

Source Savills Research

Average residential rent income by county/local authority

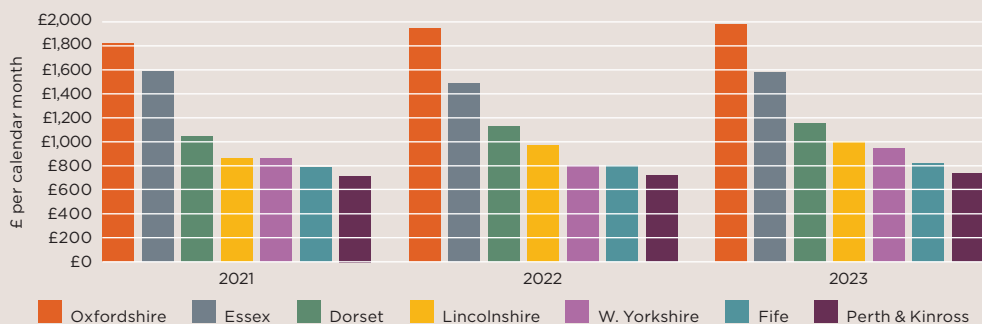


figure 8

Source Savills Research

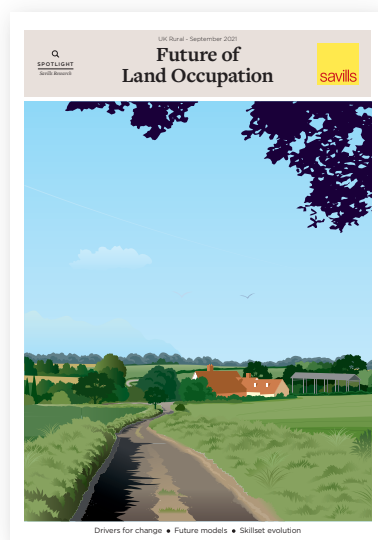
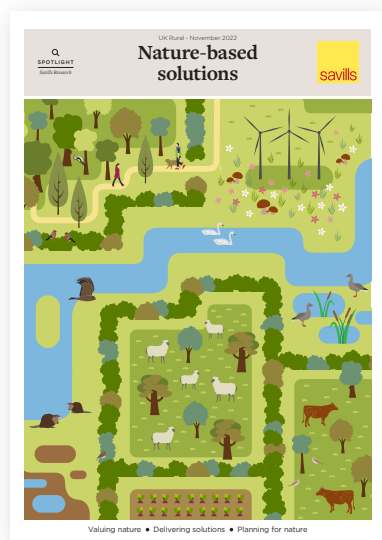
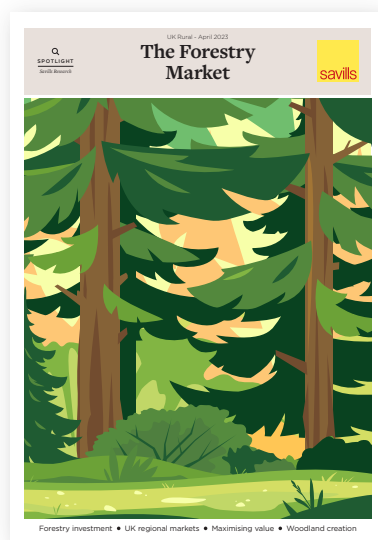
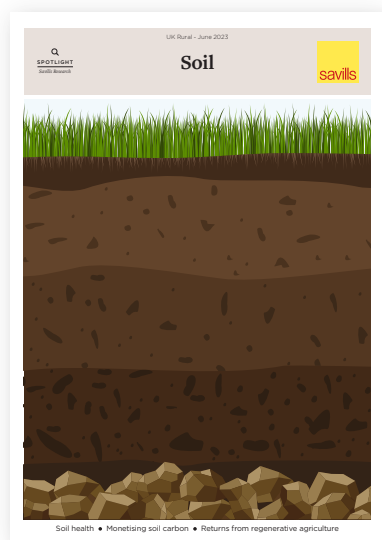
MARKET PERFORMANCE

Savills forecast that bank base rates will gradually reduce from the middle of 2024 as inflation is tamed, which will see the mortgage markets settle down and a marked improvement in mortgage affordability. This should ease the demand pressure for rental properties and may see some stabilisation in rental growth. For UK mainstream house prices, in early 2023 Savills forecast a nominal price fall of 10% for the year that should gradually bring more buyers into the market and allow a return to modest house price growth from 2024 onwards, with a more pronounced rebound in 2026.

IMPACT ON THE RURAL ESTATE PORTFOLIO

Most estate cottages are situated in a sought-after location and this combined with the greater certainty of a long-term letting, will mean that demand for the estate cottage or house should remain strong.

The impact of both increased costs and energy efficiency demands on expenditure will only continue for a relatively short time. Subject to the strength of the local market, estates can anticipate net returns from their let residential property to return to more attractive levels and in many cases they will become a key component of estate financial performance again. Resisting the short-term urge to sell may well therefore be wise.



Savills Research

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