Ex-council houses

Former council houses and flats can make excellent investments, says one specialist

Margaret Thatcher's Right to Buy was a flagship policy, transforming the lives and fortunes of many thousands of council tenants.

It was, however, controversial at the time of introduction in 1980, and it remains controversial now: many former council tenants who bought their homes at big discounts have sold them on to private landlords.

Indeed, it is estimated that 40% of council flats bought through Right to Buy have now been purchased by private landlords and are being rented out – at rents far more expensive than those charged by the councils.

And in a further twist, some of those councils are now having to rent back the homes they formerly owned in order to fulfill their homelessness obligations.

Earlier this year, the Commons Communities and Local Government Select Committee expressed its concerns at the situation.

It said that "measures to limit homes sold through Right to Buy ending up in the private rented sector should be explored".

Lucrative area

The trend is most acute in London. Last year, the social housing trade magazine reported that a two-bedroom flat listed on Zoopla in south London was being rented through a letting agent at £1,712 per month, a 409% mark-up on the average rent for a council flat in Southwark of £418.

This does suggest that, leaving aside questions of ethics, politics and whether this is a step too far even for the most fervent capitalists, this is a highly lucrative area for property investors.

It is also one that, in time, could be an expanding sector, given the Government's wish to expand Right to Rent into the social housing sector (tenants who buy would probably be able to sell their homes on the open market after ten years).

But are there any downsides? Well, the most obvious is that council housing stock is not the prettiest. There may also be a perceived stigma about living in a former council house or flat.

Mtaylor848

Former council homes can be turned into successful private lets – the lower the rise, the better

Refurbishment will not be cheap, but it will be necessary.

On the plus side, some of this stock may have large gardens, which may appeal to families, and older council stock has a large floorplate – giving the ability to add one or even two more rooms.

Most of these homes, if unexciting in architectural terms, have also been well built.

In addition, buying existing properties, rather than new or off-plan, provides immediate income.

Kerb appeal

If former council stock lacks kerb appeal, it certainly has an attraction for property investors, according to Dominic Field of specialist firm Temple Field.

The company operates only in London but believes its highly successful model could roll out anywhere.

Field believes that the lack of kerb appeal is of no concern to private tenants, while the perceived stigma is vanishing fast.

Field, together with Ben Temple, set up the firm three years ago after Temple's previous firm, Temples, acquired 66 former local authority properties at a cost of £13.5m, including the cost of refurbishment.

The capital valuation of those properties is today estimated at almost double – £26m.

Between 2003 and 2013, the properties delivered an estimated total unleveraged return of 15.6% per annum on average – but significantly higher when utilising borrowing from one of the buy-to-let mortgage providers in this sector.

Low rise, low density

Temple's original business model was to buy up ex-council stock and sell it on to friends and associates – who included Field – while the firm managed the properties.

Temple Field's model is slightly different in that it buys up the properties, refurbishes them and then sells them on, with the option of a third-party agent, Gordons, managing them. ➤

CASE STUDY: MEADOW ROAD, LONDON SW8

- Purchased August 2015; refurbishment completed mid-September 2015; tenancy commenced October 10, 2015
- 3/4 bed, 1-bath ex-local authority house ten minutes' walk from Vauxhall station (Zone 1), and from the site of the new Nine Elms tube station (due to open 2020)
- Strategy: convert to 5-bed, 2-bath for rental to professional sharers on one AST
- Purchase price: £580,000 (asking price £595,000)
- Refurbishment costs: £45,000

29th September 2015
London Investment

1 Meadow Road SW8 1QB	Rental today 3 bed convert to 5 bed (Assumed furnished)	Sq ft 872	Rental + 1 year (see footnote) 3 bed convert to 5 bed (Assumed furnished)	Sq ft 872
Leasehold				
Asking price		595,000		595,000
Purchase price		580,000		580,000
Saving		15,000		15,000
Purchase price (rate psf)	**£665***	**580,000**	**£665***	**580,000**
Gross Yield		**6.8%**		**7.1%**
CAPITAL				
Purchase costs:				
Stamp Duty Tax (inc VAT)	19,000		19,000	
Refurbishment / Furniture	45,000		45,000	
Solicitors fees/disbursements	2,000		2,000	
Buyers Agents fee @ 2.25%	13,050		13,050	
VAT on costs	3,010		3,010	
Total costs		82,060		82,060
Borrowing				
Deposit Required @ 0% LTV	0%	580,000	0%	580,000
Total Cash Required		**£662,060**		**£662,060**
INCOME				
Gross Investment Return			5% rental growth 2016	
Rental (per month)	3,272		3,435	
Rental (per week)	**755**	39,260	**793**	41,223
Less expenses				
Initial tenancy fee	100		100	
Inventory/Check in fee	400		400	
Service chge/Repairs	850 estimate		850 estimate	
Gas/Electric Safety Test	100		100	
Letting / Management fee at 10% p.a.	3,926		4,122	
VAT on fees	811		850	
Total expenses		6,317		6,553
Net Income		32,943		34,670
Net Yield (on purchase price)		**5.68%**		**5.98%**
Estimated price post refurb / 12 months 8% capital growth		**£645,000**	**£790**	**£750,600**
Capital uplift		**11.2%**		**20.1%**
Total Return before tax				**26.1%**

Footnote: Rental and capital growth forecasts for London sourced from Savills Residential Focus.
Risk Warning: These figures are for illustrative purposes only and exclude any allowance for voids. Projected rents can vary. The value of investment property can go down as well as up so investors must seek professional advice from an Independent Financial Adviser before entering into any contractual arrangements.

- Estimated capital value post refurbishment: £695,000
- Rental value achieved: £755 pw
- Current gross yield 6.8%, projected gross yield at end of year one: 7.1%
- Approx 11% capital uplift / approx 37% uplift at 75% LTV
- Total projected unleveraged return before tax at the end of one year: approx 26%. Total projected return for 5 years after tax (see assumptions): approx 40%

Meadow road cash flow no debt

	Purchase	Aug 15 to Aug 16 (income from due to refurb)	Aug 16 to Aug 17	Aug 17 to Aug 18	Aug 18 to Aug 19	Aug 19 to Aug 20
Purchase Price	[illegible]					
Purchase costs inc refurb/fees	[illegible]					
Growth in Price (as noted)		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Sale Price assuming growth p.a. above		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Sale costs at 2% plus VAT						[illegible]
Net sale proceeds						[illegible]
Growth in rental Prices (as noted)		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Rental income assuming growth above p.a		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Actual Gross Income Yield		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Initial tenancy fee		[illegible]				
Inventory/Check in fee		[illegible]				
Service chge/Repairs		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Ground Rent		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Gas/Electric Safety Test		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Letting and management fee 10% p.a.		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
VAT on fees		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net Cash Flow	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net Income Yield before Tax		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Cumulative Income Yield		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net Taxable Income		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Net Taxable gain after 5 years						[illegible]
Capital Gain percentage after 5 years						[illegible]
Income Tax @ 40%		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Capital Gains Tax at 28%						[illegible]
Net Income Yield After Tax		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Capital Gain after Tax						[illegible]
Cumulative Total Return after Tax and without debt		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Notes:
[illegible]

BEFORE

AFTER

Not all of the ex-council stock is sold to private landlords, and Field cites a property bought by parents for their sons to become owner occupiers.

However, it is mainly investors who find former council stock so appealing.

Why?

Because this stock is relatively cheap to buy and delivers strong returns.

Ex-local authority stock is often well sited in terms of amenities such as tube stations. Demand is strong among private tenants, who typically include retirees and divorcees.

In London, Temple Field looks for very particular ex-local authority stock: it needs to be low rise and low density. The firm also goes for 1960s and 1970s ex-council stock because of the large floorplates.

An additional benefit is that service charges are about a third of the local norm.

Could it work elsewhere?

In London, Temple Field looks to buy up stock in Wandsworth, Fulham, Clapham and Battersea.

It has looked outside London, notably Reading, but found that local licensing rules in the town centre, close to the station and where it wanted to buy, would have kicked in.

Field also warns that this could be a problem elsewhere.

Former council stock also lends itself to conversion – a three-bed home could easily become a rental property with four or five bedrooms.

However, some local authorities require licensing, or use Article 4 Directions – ie require planning applications, which they may refuse – if properties are turned into small HMOs after conversion.

Borrowing?

Mortgage lenders are often said to be hostile to funding purchases of former council stock.

Field is emphatic that this is not the case, saying it has never been a problem, as long as the properties are low rise.

Lenders, he says, do not like any stock which is too high – often ten or more storeys but which can be higher than five.

And if lenders require buy-to-let monthly repayments to cover as much as 145% of rent, this is not a problem, he insists. ■

CASE STUDY: CEDARS ROAD, LONDON SW4

- Purchased July 2005; refurbishment completed end August 2005; tenancy commenced September 2005
- 3-bed, 1-bath ex-local authority leasehold flat 10 minutes' walk from Clapham Common tube
- Sourced via local agent
- Strategy: convert to 4-bed, 1-bath for rental to professional sharers on one AST
- Purchase price: £220,000
- Refurbishment costs: £29,500
- Estimated capital value today: £450,000
- Rental value achieved in 2005: £350 pw
- Rental value achieved in 2014: £550 pw
- Gross yield at purchase: 7.3%
- Current gross yield: 6.4%
- Gross average total unleveraged return: 12.6% per annum
- Gross average total leveraged return (75% LTV): 40.7% per annum
- Approximate doubling of capital value over 9 years.