

Responsible regulation

Reforming the mortgage market

October 2009

Background

The Turner Review (March 2009) suggested that there should be a debate about future mortgage regulation in the UK during this summer. This position paper constitutes our contribution to that debate.

The British Property Federation is the representative body for investors in property. Our focus is on how the mortgage market affects landlords in the private rented sector, and therefore specifically buy-to-let mortgages. This is not our first foray into the subject of buy-to-let investment and mortgage regulation. We highlighted significant concerns we had with some practices back in the spring/summer of 2005, through a series of meetings with lenders, HM Treasury and the Financial Services Authority. At that time, we were particularly concerned about:

1. Some practices in the residential property investment market. For example, the valuation and price paid for new build properties, especially flats, which was not transparent (and sometimes open to fraud) because of sales incentives offered by the developer. (Procedures have since been tightened up through self regulation by the CML, RICS, Law Society and HBF.)
2. The extent to which lending was being made to people with no experience of being landlords, and with insufficient due diligence as to their ability to service one or often more buy-to-let mortgages.
3. The investment advice being given by property investment clubs.

Policy position

In reaching our position, we have had to weigh up a number of factors. Firstly, that many of our members rely on bank finance to fund investment; such lending has generally had a positive impact, financing the housing supply that has to a large extent met housing need over the past decade. Three million households now live in the private rented sector – that is an additional one million households compared with a decade ago.

Secondly, however, we are conscious of the impact that irresponsible lending and investment advice has had on the reputation of the sector. If the sector is attracting investors who cannot service their mortgages, then that not only has consequences for them, but also on the management of the property, on-going occupancy of the tenant, and wider image of the sector.

Equally, we have seen that the consequence of irresponsible investment and lending is that it now constrains the activities and investment of those professional landlords, small and large, who want to access finance to invest. Lastly, we have also recognised the impact that past practices have had on tenants and people in our communities.

Issues and recommendations

We believe there are three particular consumer issues that Government should be seeking to resolve as it considers future regulation of the residential mortgage market:

1. The position of the tenant in situations where the landlord is in default

We agree with the Government that tenants should have rights when their landlord's property is being repossessed and generally that is best facilitated by the agreement being binding on the lender where the lettings are authorised by the lender and comply with relevant terms of the mortgage agreement. Problem occur where the borrower lets the property without the knowledge or consent of the lender, and therefore in contravention of his or her mortgage agreement. This will not normally be the case with a buy-to-let mortgage, but may be the case where the loan has been made on owner occupied terms. In such cases, tenants may only become aware of a problem when the bailiffs present a warrant for eviction, requiring them to leave at short notice. We fully support the Government's objective to provide such tenants with a minimum of two month's notice prior to eviction and to seek to ensure that good practices are pursued in the meantime, so that no tenants find themselves being evicted at short notice. We look forward to contributing to the detail on the Government's suggestions, which have recently been issued for consultation.

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Case study 1

A Berkshire Citizens Advice Bureau reported that a man had bought two buy-to-let properties as an investment in North-West England. The properties were overvalued, and rent estimates were over optimistic. One property had never had a tenant, the man was more than three months behind with mortgage payments, and the lender was seeking possession. The other property was guaranteed to provide a rent of £600 pm for a year, against a mortgage payment of £650, which he had thought he could manage. The man subsequently discovered that the tenant was in receipt of housing benefit totalling £450 per month, and that this was the going rate for rent. There is now a £200 pm gap. The mortgage is fixed for two years, and the fix has one year to run.

Sourced from CAB written evidence to the Treasury Select Committee, fifteenth report of session 2008/9 on mortgage arrears and access to mortgage finance

2. Buy-to-let lending practices

The media has communicated various painful stories of people who invested in the buy-to-let market when it was perceived to be booming. Voids and other impacts have since led to a drop in their property income and, with little other spare income they have lost some if not all of their investments, and have put in jeopardy their continued occupation of their family home.

Mortgages to owner occupiers are currently regulated by the FSA, but buy-to-let lending is not. The theory is that buy-to-let is more akin to a business loan and the borrower is more financially adept; however, it is important to regulate mortgages to owner occupiers because a bad lending decision could put the family home at risk.

We would argue that many buy-to-let borrowers are not any different or more financially adept than the public at large, and that events have shown that their family home can be put at risk.

Lending practices for buy-to-let purposes were generally relaxed during the credit boom, as lenders competed for business. For example, at the start of buy-to-let, most lenders ensured that rental income provided cover for mortgage repayments, so that ratios of 130% to 150% were commonplace. As the market boomed, ratios fell below 125%, and sometimes were at parity.

Case study 2

A Citizens Advice Bureau in London saw a couple who had bought 23 buy-to-let properties with mortgages from eight different lenders, although their income was no more than £1,500 per month. They were buying their own home via a shared ownership scheme. They were finding it impossible to continue to make all the payments on the mortgages, particularly because the interest rates charged on the mortgages were so high, and the properties were empty at times. Two of the properties had now been repossessed, and the remaining 21 had been taken into receivership. The clients had had to leave their own home, which was in negative equity. They were feeling extremely stressed and were considering petitioning for bankruptcy.

Sourced from CAB written evidence to the Treasury Select Committee, fifteenth report of session 2008/9 on mortgage arrears and access to mortgage finance

Case Study 3

Rosemary Jane, like thousands of other educated, middle class homeowners, believed property investment was the sensible way to supplement her pension and finance a comfortable retirement. But her foray into buy-to-let has left her staring into a financial abyss where everything she owns, including her home in Portsmouth, is in jeopardy. And at 57, retirement is out of the question - probably for a long, long time.

Seduced by the sales patter of property clubs....., Rosemary bought three properties in 2004 whose values were questionable at the time and which are now falling. Rosemary Jane fears that her property investments could lead to her losing her own home in Portsmouth.

Sourced from This is Money, 6 April 2008

It is difficult to be prescriptive on ratios of this kind. There will be instances when a lower ratio may be acceptable with a particular borrower. However, using mortgage brokers, borrowers will be able to shop around extensively. Brokers will know which lenders have easily overcome mortgage hurdles for marginal borrowers, concentrating the risk such borrowers pose rather than sharing it around.

We recommend that buy-to-let loans should be regulated by the FSA alongside other mortgage products, such as the mainstream mortgage market, Shari'ah loans, equity release and sale and rent back. We considered whether the FSA should regulate buy-to-let mortgages as an investment, rather than a lending product, but do not believe it should. Such a measure would involve significant work on the part of the lender, significant added cost and therefore a significant constraint on the buy-to-let mortgage market, which is not our desire.

With local knowledge, the landlord will often be in a better position to judge the merits of an investment decision. The lender's job is to ensure that its lending is sufficiently prudent, both for its own sake and the sake of the borrower. Our hope is that FSA oversight of buy-to-let mortgages will ensure there is a check on ensuring lenders, and the market as a whole, are pursuing prudent lending policies.

3. The investment advice provided by property investment clubs

Whilst we do not believe that buy-to-let investment should generally be regulated as an investment activity, there was a specific class of intermediary, that, as some of our case studies have illustrated, was particularly culpable for bad investment decisions and the subsequent consequences during the credit boom, namely property investment clubs. Typically these would offer a seminar at a local hotel at which potential investors would be given information and advice about residential property investment.

Once hooked, the investor would then be offered a range of 'opportunities' for investment, often to invest in new build flats, from which the club would derive a finder's fee.

Exposés at the time in the Financial Times and Daily Mail illustrated that the advice being provided at seminars was often poor, heavily biased towards the returns that investors could make and not the risks they faced. However, neither the advice nor sourcing of property for investment purposes is currently classified by the FSA as a regulated activity. This is because the clubs are not giving specific advice about particular products, unlike an Independent Financial Adviser.

We believe strongly that property investment clubs were a powerful influence on many amateur investors' investment decisions during the boom, persuading them to invest in property, and, very importantly in many cases, which property. We would therefore like Government to go beyond existing regulation – which, via the Office of Fair Trading, is reactive in closing down clubs that are acting unlawfully – to a regime where property investment clubs are regulated for the advice they provide, in the same way as Independent Financial Advisers.

Summary of our position

The BPF believes the Government should intervene in three specific ways to tackle some of the worst practices that emanated during the credit boom and to stop their impact on tenants, landlords and lenders.

1. Tenants should be protected from eviction at little notice where their landlord is in mortgage default and was letting out the property against the terms of the mortgage agreement. We support the Government's intention to remedy this.
2. Buy-to-let mortgages should come within the FSA's remit of mortgage regulation (rather than investment regulation). Our belief is that oversight by the FSA would ensure more prudent lending practices are pursued by lenders. Our case studies illustrate that investors are no more sophisticated than the public at large. Imprudent lending can jeopardise their family home, drive organisations, such as Bradford & Bingley, to the point of extinction, and now constrain funding available for property investors.
3. Property investment clubs should be regulated for providing advice, as Independent Financial Advisers are. Our case studies show that many clubs were important influences in attracting people to invest in property, and also influenced the property they invested in, leading to many poor investment decisions.

Our final word would be that, as representatives of landlords, we often see the consequences of regulation that is not well enforced.

Our recommendations 2. and 3. are made on the premise that any new regulations must be well enforced. If they are not then the benefits of regulation will be lost.

Case study 4

Anne has been a taxi driver for most of her life. 'Driving day after day is long, hard work,' she says. So in January 2002, in a brave attempt to escape the daily grind, she parted with £6,000 of her precious savings to attend a three day property investment seminar in London.

It promised to change her life – and it has. Organised by one of a myriad of shady property clubs that have long since disappeared, the seminar was nothing but a hard sell. 'They said there was no cash needed,' she says. 'The warning bells should have rung then.'

But they didn't and instead Anne, 52, who lives near Glasgow, was introduced to an array of mortgage brokers, developers' agents, solicitors and property valuers. Over the next three years she was persuaded to buy four flats in three Glasgow developments. The flats were all bought before they were complete, with little or no down payments. The developers' agents, and all the other middlemen, took a commission.

Most of the individuals and companies involved in these transactions have since vanished into the murky and unregulated world of property promotion and development. Their names, phone numbers and employees have disappeared. But the flats, and the massive mortgage debts attached to them, have not.

Tenants were hard to find. No flat ever achieved the rents promised by the valuers. Even though the flats were new and their values questionable, she had no trouble finding mortgage lenders.

Over the years, mortgages came from numerous banks, including big names such as GMAC and Bank of Scotland. By this year, though, Anne had moved the mortgages to one lender, Mortgage Express, part of Bradford & Bingley.

Earlier this year, Mortgage Express started repossession. All four flats are now in the hands of the lender, with three on the market at prices far lower than their original valuations – and lower than the mortgages secured on them.

Anne is distraught. 'I've worked so hard all my life,' she says. 'Nothing has come easily for me. I went on that property investment course and I came back full of promises, bowled over with what could be achieved. I was told I could make £100,000 on these properties. I didn't know that hundreds of people were trying to do the same thing. Maybe I was naive, but I've done nothing wrong.'

Sourced from This is Money, 27 September 2007