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Buy-to-let Mortgage Arrears:

Understanding the factors that influence landlords' mortgage debt

Alison Wallace and Julie Rugg
Centre for Housing Policy

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About the authors

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We will put our customers at the heart of everything we do. We are already re-shaping our business so that by working together we can focus all our future decisions around our customers. The investment the Group is making is considerable and will have far reaching benefits in expanding products and capabilities for our customers – including finding new and innovative ways to help homebuyers. As a result, we are very pleased to be supporting research in this area. The recently announced Helping Britain Prosper Plan is designed to make a visible difference for all our customers and within our communities.

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Forewords

Lloyds Banking Group

Lloyds Banking Group is one of the biggest providers of Buy-to-Let mortgage finance in the UK, primarily through the Birmingham Midshires brand. Buy-to-Let mortgages have been available for nearly 20 years, and as demand for private rented property grows, deeper understanding of the market is becoming ever more important.

To aid this understanding we have commissioned this report, in partnership with Shelter, because there is little research available specifically exploring the issues that cause landlords to default on their mortgage.

There are clear lessons within this research for landlords, legislators and lenders that can be used to improve the private rental sector for all.

Potential landlords need to understand their market and treat the letting proposition as a business. For the best chance of being successful, they should have a clear business plan and ensure they have enough resources to cover events that cause financial stress – such as repairs and voids.

Legislators must review the obstacles preventing Landlords from getting their property back where rent isn't being paid. Small scale landlords often do not have large reserves to draw upon in order to pay for mortgage payments and maintenance when a tenant stops paying the rent.

A balance clearly needs to be struck to ensure rogue landlords don't abuse the system, but faster court processes to enable landlords to evict non-paying tenants are needed before landlords will risk entering into longer-term tenancies that some tenants want.

Finally the report helps answer some of the questions lenders will have when called upon to look at lending policies. It clearly demonstrates that tenant circumstances alone rarely cause landlords to default. In fact, it shows most make as much effort as owner-occupiers to keep their hard-earned property, often subsidising payments from other income.

Lenders can help by engaging with Landlords, Government and organisations like Shelter in order to ensure mortgage conditions and processes support a strong and vibrant private rental sector whilst still delivering the risk mitigation required.

At Lloyds Banking Group we recognise our customers are both landlords and tenants, and believe this research provides some of the answers to help us deliver Buy to Let mortgages that are appropriate for the changing market for private rental properties.

Stephen Noakes
Home & Lifestyle Director
Lloyds Banking Group

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Shelter

Spiralling house prices and the shortage of social housing means that private renting is increasingly the only option for low and middle income families unable to afford a home of their own. In the long term we must build the homes Britain needs – including genuinely affordable homes – but in the interim we must urgently fix private renting for the millions of ordinary people who will be renting for the foreseeable future.

Alongside ensuring that the Private Rented Sector is genuinely affordable, it is critical that we also make it more stable. Shelter has proposed the Stable Rental Contract, a five year tenancy model that provides predictability for renters and landlords alike. We would like to see the Stable Rental Contract as the mainstream offer for most private renters; however, practices in the buy-to-let market are still based on yesterday's private rented sector, usually stipulating a maximum twelve month tenancy. We welcome Lloyd's decision to commission this report to deepen understanding of the challenges of altering current industry norms. By demonstrating a lack of any significant relationship between landlord arrears and tenancy length we hope this report will instil confidence in the lender community and enable longer-term tenancies to become more widely available.

Although investigating arrears and tenancy lengths is where this report started, its scope quickly expanded to consider the general question of what causes buy-to-let mortgage arrears. Stability for renters requires a secure and stable market because even when families have the stability of a longer tenancy, landlord mortgage arrears could mean eviction and the loss of their home.

Given the greater role the private rented sector is expected to play in years to come, the report does not always make for comfortable reading. Its examination finds worrying levels of inexperience in many parts of the buy-to-let market, with significant numbers of "have-a-go" landlords with poor business plans and limited resilience to financial shocks. With an interest rate rise in the near future almost certain, we should all be concerned about the knock-on effect this could have on private renters.

This report also finds no clear relationship between accepting tenants in receipt of housing benefit and landlord mortgage arrears. It demonstrates that the rental market has the capacity to rely on perception rather than robust business sense. In a climate where some landlords have made headlines by refusing to accept those who use housing benefit to pay all or part of their rent, it is those renters who need a safety net who will lose out from misconceptions about the risk of arrears.

We all have an interest in improving private renting. Lenders have a role to play as they set the terms and conditions of their mortgage products and their business practices, which should reflect genuine risks and rigorously ensure landlords' ability to repay. By taking the lead, Lloyds have demonstrated their commitment to playing their part and provided an example to the rest of the sector to follow.

Campbell Robb
Chief Executive
Shelter

Buy-to-let Mortgage Arrears:

Understanding the factors that influence landlords' mortgage debt

Executive Summary

Buy-to-let mortgages underpinned the expansion of the private rented sector, which in the 2000s, brought in a range of new small sideline investors. The private rented sector now plays a critical role in the housing market, accommodating excess demand from social renting and homeownership. This new role has prompted calls for improvements in the quality and management of the sector and for greater security for tenants who wish to stay long term. This is the first study to examine the factors that lie behind buy-to-let mortgage arrears, which have the potential to increase the churn of properties and landlords and thus undermine stability in the sector. It is based upon analysis of survey data, loan book data and in-depth interviews with landlords and lenders.

Key findings

- The stock of mortgage arrears in the buy-to-let sector is lower than in the residential market but annual possessions in the buy-to-let market are slightly higher. Lenders have a greater appetite to move to possess in the buy-to-let market as the property is not the borrowers' home and the market is unregulated.
- Landlords are more affluent than the wider population but there are indications that a minority of landlords have precarious finances. Over a fifth of landlords in the 2010 English Housing Survey Private Landlords Survey (EHS-PLS) reported problems with their mortgage costs. Three per cent of buy-to-let loans in the lenders' data were one month or more in arrears in September 2013. There was evidence of landlords subsidising their rental property or portfolios to manage or avoid mortgage debt. While this indicates a strong commitment to the loan it also suggests that landlords' financial stress goes beyond the official arrears and possession figures.
- The ability of a landlord to meet their buy-to-let mortgage commitments are challenged by events arising in the market- tenant demand, rental income, house prices; from the business - the effectiveness of lettings, rent collection, property management; and from policy - changes to housing benefit or regulation, for example.
- Through the recession 2008-9 rents dropped, tenant arrears rose, void periods increased and house prices fell. Change was not uniform and market conditions deteriorated less and recovered the fastest in the southern regions of the UK. There is therefore an imbalance in the regional distribution of buy-to-let arrears.
- The most significant factors that increased the odds of a landlord reporting *problems with their mortgage costs* were letting property in the North East, and reporting problems with finding builders, tenant damage, local housing benefit administration, deposit disputes and asking tenants to provide a reference. These are indicators of letting in difficult markets and problems relating to the operation of the business. These factors account for a quarter of the variance of landlords reporting problems with their mortgage costs.
- The factors most likely to increase the odds of loan accounts being *one month or more in arrears* were: single applicants, letting a flat, high current loan-to-values, having multiple loans, negative equity and taking out the loan during the period 2006 to 2008, letting property in the North East, London and in Northern Ireland. The influence of these factors on the incidence of buy-to-let

mortgage arrears was shallow and overall only explained nine per cent of the observed variation between the loan accounts. These factors are also likely to reflect other attributes associated with the exuberance of letting at the peak of the housing market.

- Lenders and regulators conceive of buy-to-let as a business but it is not always operated as such. Market and policy risks become more apparent in weaker housing markets where landlords must demonstrate more proficient business skills to sustain their property or portfolio. Stronger markets are more forgiving to landlords who have, or had, less business-orientated approaches to their letting activities.
- Across all markets adverse events in landlords' *personal* and/or financial lives also contribute substantially to the incidence of buy-to-let mortgage arrears.
- Some professional landlords successfully let properties to tenants in receipt of housing benefit, but this sector demands a different skill set and more intensive management.
- The 2009-2010 EHS-PLS data does not associate housing benefit paid directly to the tenant with tenant arrears, but interviews for this study found problems with tenants not passing on housing benefit or claiming incorrectly. This had contributed to some landlords' mortgage arrears but did so in the context of difficult markets and/or limited experience.
- Lenders were also complicit in supporting poor investments, notably at the height of the market prior to the financial crisis. Lenders with more prudent approaches to the buy-to-let market have fewer arrears, and after 2008 lenders were adopting a cautious approach.
- However, by pursuing a mainstream part of the market lenders potentially could undermine the ability of the private sector to house a wide range of households, including those on housing benefit. However, there were indications that policy changes in this area combined with the availability of alternative financially robust tenants in some markets exerted a greater influence over whether landlords let to all tenant groups than lender practices.
- Financially insecure landlords may undermine the ability of the market to deliver a stable secure and sustainable private rented sector. Lenders have great leverage in supporting these wider ambitions for the sector. This would entail paying greater attention to appraising the sustainability and proficiency of landlords to manage in their local markets during mortgage applications.

1: Introduction

Summary

- The private rented sector now plays a critical role in the housing market, accommodating excess demand from social renting and homeownership.
- The sector has expanded substantially over the last decade, but to fulfil its greater role in the housing market there are calls for private renting to be made more secure, stable and professional
- Buy-to-let mortgages have contributed to the expansion of the sector and now lenders are under pressure to permit landlords to offer longer term tenancies and accept tenants on housing benefit.
- This research examines the factors that may undermine landlords' finances and present risks to buy-to-let mortgages to inform future policy discussions.

Background

The private rented sector is an essential component of the UK housing system, performing a wide range of crucial roles that complement and underpin the operation of both the owner occupied and the social rented housing sectors, in addition to providing accommodation of 'first choice' to many households. The sector has expanded substantially over the last decade, but to fulfil its greater role in the housing market there are calls for private renting to be made more secure, stable and professional. The Government has produced a model long-term tenancy for the sector and, in addition, the Opposition propose a national register of landlords. Lenders have provided the finance through buy-to-let mortgages for the expansion of the private rented sector and are also under pressure to remove barriers to the introduction of longer term tenancies and to permit landlords to let to a wider range of tenants, including those in receipt of housing benefit. However, there is a concern that the absence of a robust understanding of the factors related to landlord mortgage arrears may prohibit innovation in the market, and may limit the support that lenders can offer. These policy discussions will be informed by a precise understanding of risks in the market.

Overall, more than one half of private rented sector dwellings in England were acquired with a mortgage. Private individual landlords, which are the most common type of private landlord, were the most likely to have purchased their property, and they were also the most likely to have used a mortgage to do so. Buy-to-let mortgages were introduced by the Association of Residential Letting Agents (ARLA) in 1996, and now form an increasingly important part of the mortgage and housing market. Following the onset of the financial crisis in 2008 there were concerns about the commitment and sustainability of buy-to-let landlords, however, the market recovered remarkably well. Lending to first time buyers increased slightly during 2013, which has the potential to undermine demand for private renting and subsequently the buy-to-let market. However, constrained access to social housing is likely to remain and the chronic undersupply of homes means that the private rented sector will retain its new role in the UK housing system for the immediate future.

The buy-to-let and residential mortgage markets have shown different patterns in respect of mortgage default during this market downturn, as possessions have reduced steadily in the residential market but have largely been increasing in the buy-to-let market. Unlike the relatively extensive literature regarding residential mortgage arrears and possessions, no studies have previously examined the factors implicated in landlords accruing mortgage arrears. At the outset of the recession the position of tenants was an urgent policy concern as tenancies were brought to a premature close due to the landlords' mortgage default, although legislation was introduced to overcome this issue for qualifying tenancies. And yet, the private rented sector has not attracted the same degree of research as other parts of the housing market. In the context of debates about how to remove the volatility from the UK housing system and develop a stable and secure private rented sector, providing robust accounts of why a minority of landlords struggle with mortgage payments is timely.

Research aims and objectives

This research aimed to improve the understanding, among lenders and the wider industry, of the reasons behind landlords' buy-to-let mortgage arrears and had three key objectives:

1. What factors are related to buy-to-let landlords' mortgage arrears and possessions?
2. How do lenders and landlords manage the incidence of buy-to-let mortgage arrears and what influence does the management of buy-to-let mortgage arrears have on the outcomes?
3. What do the findings suggest can be done by lenders and landlords to prevent or mitigate the impacts on lenders, landlords and tenants of buy-to-let mortgage arrears?

Research methods

The study involved mixed methods and was undertaken in four phases:

1. A quantitative analysis of secondary data using the English Housing Survey Private Landlords Survey 2010 (EHS-PLS);
2. A quantitative analysis of buy-to-let loan book data supplied by a single lender;
3. In-depth qualitative interviews with eight buy-to-let lenders; and
4. In-depth qualitative interviews with 25 buy-to-let landlords and two landlord representatives.

The English Housing Survey Private Landlords Survey (EHS-PLS) includes approximately 1000 landlords and the data were collected during 2009-2010. It predates some policy and market changes but provides robust data relating to landlords and their tenants. The lender loan book data includes details of all loans made by a single lender from 2001 onward and its total of 338,908 loans represents around a quarter of the entire UK buy-to-let loans. The data provides a rich source of information about the size and location of landlords and their properties, valuations and mortgage debt. The in-depth qualitative interviews were undertaken between September and December 2013. The lenders interviewed offered perspectives from around two-thirds of the buy-to-let market. The landlords were largely drawn from across the UK and were mainly landlords with more than one property, and comprised a mixture of landlords in arrears, landlords struggling financially and landlords who had no problems meeting their mortgage commitments.

Further details of the research methods adopted are provided in Appendix 1 and of the topic guides used in the in-depth interviews in Appendix 2 and Appendix 3.

Structure of the report

Chapter 2 provides an overview of buy-to-let arrears as they stood in Spring 2014 and considers what the existing knowledge base tells us about landlords' finances and the range of risks and pressures they face. Chapter 3 and Chapter 4 present the results of the analysis of the English Housing Survey and the lenders' loan book data respectively. These analyses provide an overview of the landlords surveyed and identify the various circumstances associated with landlords experiencing problems with their mortgage costs and loan accounts that carry mortgage arrears. Chapter 5 reports the findings from the qualitative in-depth interviews and provides substance to unresolved questions evident in the quantitative analysis. The final Chapter 6 provides a discussion of the issues raised by the evidence collected in the study and concludes with some broad recommendations for lender and landlord organisations to consider.

2: Buy-to-let and landlords' finances

Summary

- The stock of mortgage arrears in the buy-to-let sector is lower than in the residential market but possessions in the buy-to-let market are slightly higher. Lenders have a greater appetite to move to possess in the buy-to-let market as the property is not the borrowers' home and the market is unregulated.
- The rise in buy-to-let lending reflects the growing confidence among landlords who see many aspects of the sector improving, although not uniformly.
- The ability of a landlord to meet their buy-to-let mortgage commitments can be challenged by events arising in the *market*- tenant demand, rental income, housing prices; from the *business*, – the effectiveness of lettings, rent collection, property management; and from *policy*, – changes to housing benefit or regulation, for example.
- Through the recession 2008-9 rents dropped, tenant arrears rose, void periods increased and house prices fell. Change was not uniform and market conditions deteriorated less and improved the fastest in the southern regions of the UK.
- Landlords are more affluent than the wider population but there are indicators that a minority of landlords have precarious finances.

Introduction

Much attention is afforded to understanding the risks within homeownership across the economic and/or housing market cycle, to households, lenders and the state, and how the incidence of mortgage default can be managed (Policis, 2010; Ford and Wallace, 2009; Gall, 2009; Stephens *et al.*, 2008; Ford *et al.*, 2001). To date, there has been little focus on how market cycles impact upon the private rented sector, and in particular how landlord's behaviour and housing market turbulence translate into risks to mortgage finance in this part of the housing system. This is a curious omission as the private rented sector has expanded significantly in recent years, due to tenure shifts produced from constrained access to homeownership and limited access to social housing. The increased importance of private renting demands that closer attention is paid towards understanding factors that could undermine the stability desired in the sector.

Volatility in the UK housing market may overall have lacked the drama of the house price peaks and troughs experienced most recently in the Republic of Ireland or Spain, for example, but a degree of instability has been a defining characteristic of the UK housing market since the 1970s, since when four significant downturns have occurred (Stephens *et al.*, 2008; Stephens, 2011). Internationally, the incidence of mortgage defaults throughout the market cycle, and in particular during the downturns, are a consequence of the interaction between the mortgage market, labour market and social protection offered to mortgage borrowers, as well as changing patterns of household dissolution (Ford and Wallace, 2010). Consequently, the UK's residential mortgages are subject to greater risk of defaults than in, for example, Germany, where arrears are historically very low; or at a lower risk in comparison to Ireland or the United States (Schaber and Gill, 1999; FSA, 2012). However, it is uncertain how the changing housing market, the framework of mortgage market regulation, statutory support for tenants and/or borrowers, the labour market and changing demographics influence the buy-to-let mortgages that have supported the expansion of the private rented sector.

To begin to fill these knowledge gaps, this chapter provides an overview of existing evidence about buy-to-let, the incidence of mortgage arrears and possessions in this part of the market and the various factors that may exert pressure on landlords' finances.

The rise of the private rented sector

The importance of the private rented sector to UK housing policy has never - at least in the post-war period - been so high, with increasing policy expectations that the sector will take the strain from constraints in other parts of the housing market (DCLG, 2011a; Whitehead *et al.*, 2012). A combination of factors, including limitations on first time buyers obtaining mortgages and persistent problems of affordability of homeownership in many locations, combined with access constraints to social housing has increased demand in the privately rented sector. Indeed, there has been a significant restructuring in UK housing tenure over the last two decades. Private renting more than doubled in size between 1991 and 2011, growing from just over two million dwellings (nine per cent of the UK stock) to 4.7 million dwellings (17 per cent of the stock). Over the same period, the owner occupied stock has dropped slightly from 67 per cent of the UK stock to 65 per cent (peaking at 69 per cent for much of the 2000s); and social rented housing has dropped from 25 per cent to 18 per cent of the UK stock during the same period (CLG Live Table 101).

The origins of buy-to-let mortgage provision in the mid-1990s are well rehearsed, reflecting the poor external housing market conditions of the 1990s downturn and the under-performance of alternative asset classes. It was a market response that permitted landlords ready access to mortgage finance (Crook *et al.*, 2012; Gibb and Nygaard, 2005; CML, 2001; Rhodes and Bevan, 2003). Buy-to-let therefore underpinned the expansion of private renting. Arguably buy-to-let also met increased rental demand to which it had itself contributed, as affordability pressures prevented some first time buyers accessing homeownership and regulatory imbalances gave landlord investors competitive advantages (Wilcox, 2013; FSA, 2012).

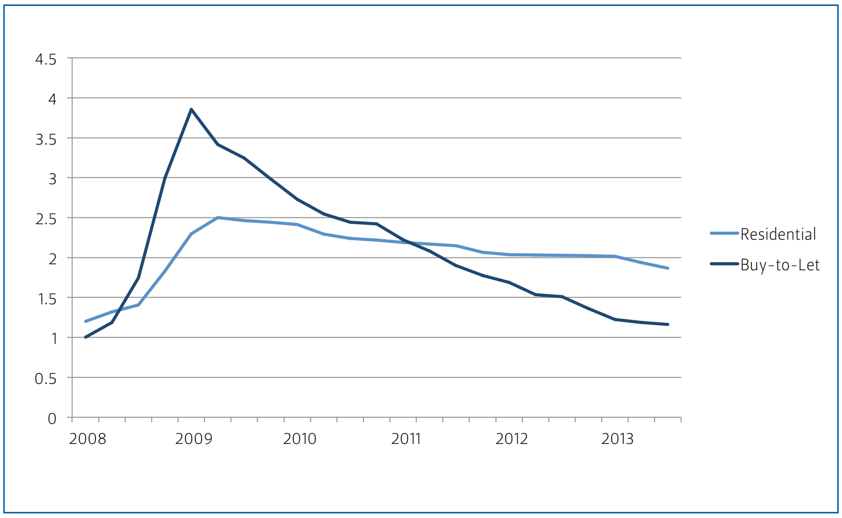
Accompanying the growth in private renting, buy-to-let lending has become an increasingly important part of the mortgage market, with the number of loans increasing from approximately 73,000 buy-to-let loans outstanding in 1999 to 1.5 million by 2013 (CML Table AP5). The market share occupied by buy-to-let loans increased from 0.7 per cent in 1999 to 13 per cent by Q3-2013 (CML Table AP7). The value of lending in this sector grew from £3.9 million in 2000 to £15.7 million by 2012, although this remains at approximately a third of the size of the market at the height of the market boom in 2007 when £45 billion was advanced (CML Table MM17). The growth in buy-to-let finance has meant that in 2010 more than one half of private rented dwellings had been obtained with a mortgage (56 per cent), a proportion that was highest amongst private individuals (64 per cent), who account for 89 per cent of private landlords within England (DCLG, 2011b). The importance of mortgage finance to this part of the housing market reinforces the significance of understanding the threats to these loans.

The rise in buy-to-let lending reflects the growing confidence among landlords who see many aspects of the sector improving, although not uniformly (BDRC, 2013). However, the expansion of the sector runs in parallel to greater demands for reform, to increase the professionalism of what has regularly been described as a ‘cottage industry’ (Rugg and Rhodes, 2008). Both Shelter and the Building and Social Housing Foundation have recently proposed that policy attention should be focussed on measures that protect the interests of the increasing proportion of families living in the sector (Shelter, 2011; Pearce, 2013). Advocates of ‘stable renting’ are seeking changes to security of tenure, to promote longer tenancies, and some level of landlord registration or licensing. The Department of Communities and Local Government has worked with industry representatives and other stakeholders, to produce a model longer-term tenancy, provided tenants with the right to request longer tenancies from landlords and proposed that letting agents belong to a redress scheme (CLG, 2013). To reflect these new uses for the private rented sector and policy ambitions there is also pressure on lenders to revise clauses in the buy-to-let mortgage terms that often limit the length of tenancy that landlords can offer tenants to 12 months, or that specify categories of tenants to which landlords cannot let properties. Two large lenders recently reversed previous policies of prohibiting landlords from letting to tenants on housing benefit and shorter tenancies, but these risks in terms of lending are poorly understood.

Buy-to-let mortgage arrears and possessions

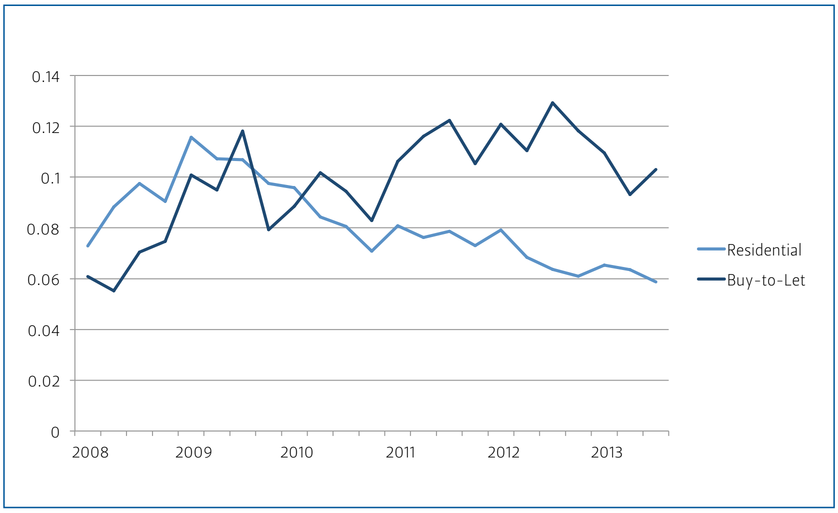
The financial crisis of 2007/8 induced an increase in arrears and possessions across all types of mortgages, but residential and buy-to-let mortgage arrears have since followed quite different trajectories. Arrears rose and fell more sharply in the buy-to-let market compared to residential (Figure 2.1). The rate of possession was initially higher in the residential market but since 2009 has fallen steadily, compared to the buy-to-let market where there has been additional volatility and up until 2012 a steady growth in possessions (Figure 2.2). The proportion of all possessions reported by CML attributable to buy-to-let loans has also grown (Figure 2.3).

Figure 2.1: Percentage of loans 3 months or more in arrears (%)



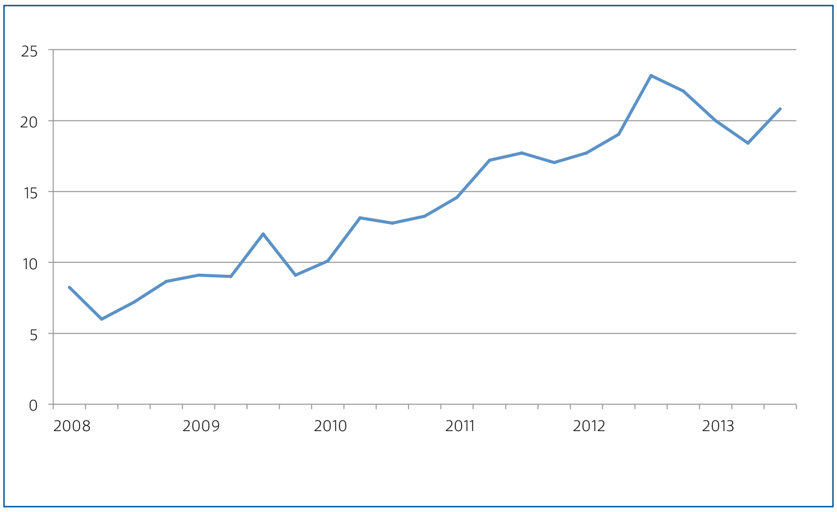
Source: AP8 CML Statistics NB: Arrears includes loans passed to a Receiver of Rent

Figure 2.2: Percentage of all loans that ended in possession (%)



Source: AP7 CML Statistics NB: Possessions include properties sold by Receiver of Rent

Figure 2.3: Buy-to-let possessions as a proportion of all possessions (%)



Source: Table AP8 CML Statistics

As they are commercial loans, lenders are less tolerant of buy-to-let mortgage arrears and do not apply forbearance in the same manner. Therefore, the duration of arrears on loan accounts is likely to be shorter than in the residential market. This means comparing buy-to-let and residential mortgage market data is problematic. The data suggests that there are fewer arrears cases and higher possessions in the buy-to-let market in comparison to the residential market. However, as landlords' accounts in arrears are referred to a receiver of rent[1] or passed through the litigation process more quickly, this is not necessarily an indication that there is a reduced flow of buy-to-let loans in arrears, just that the stock of buy-to-loans in arrears at any point in time is smaller.

The buy-to-let mortgage market is also not subject to consumer regulation. Unlike residential loans, which have been subject to regulation since 2004, buy-to-let loans are not subject to oversight by the financial services regulator the Financial Conduct Authority (formerly the Financial Services Authority). Since 2007, the regulator has closely scrutinised the UK mortgage market to ensure residential lending practices were compliant with the Mortgage Conduct of Business (MCOB) and Treating Customers Fairly. Earlier light touch principle-based regulation was replaced with a more stringent regime and a substantial review of the mortgage market undertaken, culminating in regulatory changes introduced in April 2014. The Mortgage Market Review requires that, among other things, lenders pay closer regard to the affordability of loans at the point of sale and stress test affordability for potential interest rate rises (FSA, 2012). Various thematic reviews generated a great deal of data and analysis relating to the risks in the sector, but these analyses largely omitted the buy-to-let sector.

The Mortgage Market Review floated the idea of limiting loan-to-values (LTVs) and loan-to-incomes (LTIs) in the residential market, measures that were subsequently dropped in favour of affordability checks, although there are indications that counter-cyclical provision in this area may be made to calm any over-heating markets in the future (FSA, 2010). The FSA analysis did reveal, however, that only in the buy-to-let market (and 'other' loan category) were high LTIs and LTVs of over 90 per cent associated with higher rates of default (Wilcox, 2013).

1 Law of Property Act Receivers, or Receivers of Rent, act for banks and private lenders who have secured their loans by a Legal Charge (mortgage) on a property. Under the terms of the Legal Charge the lender can appoint a Receiver to deal with a property when the terms of the mortgage are not being met – usually when repayments and interest are not being paid. The Receiver assumes management responsibility of the property, collecting rent and undertaking repairs, and occasionally re-letting the tenancy and passes the rent to the lender to meet the terms of the mortgage.

Landlord financial pressures

There is little existing evidence that informs us about the reasons that landlords have mortgage arrears, although the growing literature on the sector does provide some insight into the financial circumstances and pressures felt by landlords. Crook *et al.* (2012) identify two types of risk to landlords' letting activities. Firstly, those arising from the *market risks*, so once a property has been purchased the landlord has no further control over the capital values or the rents they can earn. Obviously tied up with how landlords appraise the properties they purchase at the outset, is the second set of risks, the *business risks*, which reflect the skills with which the landlord operates the day to day management of the property. These activities include choosing tenants, letting tenancies, collecting rent and organising repairs, for example. These matters are within the landlords' control. In addition a third risk may also be apparent as further external factors beyond the landlords immediate control are regulatory or *policy risks*. These may arise from local or central government, and examples would be housing benefit changes or local licensing. There are recursive relationships between these potential threats to landlords' finances, but this chapter organises the remaining literature and data review around these themes.

Market Risks

The key risks arising from the market relate to how the landlords' property is affected by the local housing and labour markets as well as the wider mortgage market. Key issues are the sustainability of rental income, house prices and mortgage costs.

Rental income

Clearly rental income is the key resource that landlords use to meet buy-to-let loan repayments, and factors that threaten this income stream have the potential to jeopardise the mortgage. Rental income may be threatened by a drop off in tenant demand for particular property types and/or locations, raising the possibility of greater vacant periods and declining rents; or by the failure of the tenant to actually pay the rent due if they become unemployed, for example.

Constrained new supply is a feature of the UK housing system and increased demand for housing that currently cannot be satisfied in social housing or homeownership, has largely meant higher tenant demand and some increased rents in the private rented sector. However, this strong tenant demand was not felt uniformly across the country. Consequently, more landlords were reporting rent increases in the south of England and London than in the northern regions, Scotland and Wales (BDRC, 2013). While there does seem to be some disparity regarding the scale of the any rent increases reflected in the various data sources, the regional differences remain clear. Hometrack (2013) provide an assessment of changes in rents achieved across the UK (Figure 2.4 and Figure 2.5). Overall rents fell after the onset of the financial crisis but have since recovered, although outside of London they display greater volatility. Closer analysis of changing rents shows that the greatest reductions in rents achieved were away from London and the South East, where rents declined less and recovered faster. Crook *et al*. (2012) in a study of landlords in Scotland also found buy-to-let landlords who bought near the height of the housing market and who let in areas where rents were falling after the credit crunch were experiencing difficulties with loan repayments. We can see from the Hometrack data [Figure 2.5] that Scotland experienced the greatest declines in rents during 2008 and 2009, although it also recovered sharply too.

Figure 2.4 Year on year growth in private rents 2008 to 2011

Source: Hometrack (2012)

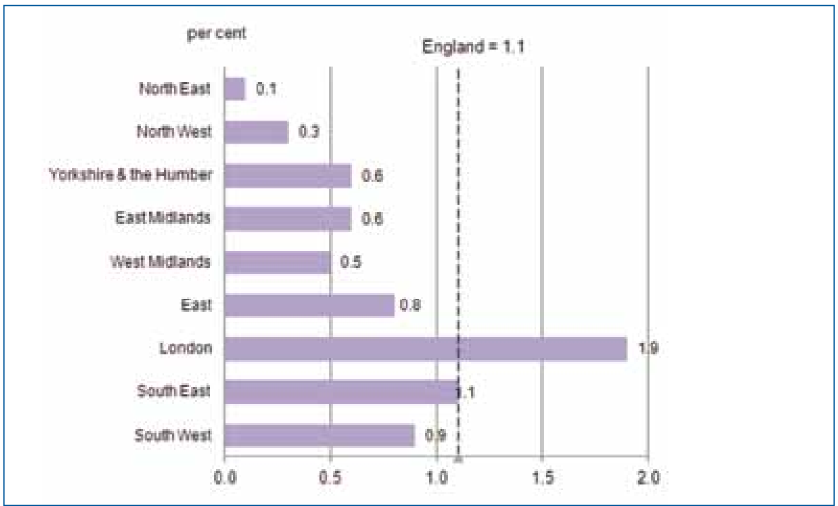
Figure 2.5: Year on year rental growth by region 2008 to 2011

Source: Hometrack (2012)

Hometrack (2013) also note that rental growth in London was running at minus one per cent in October 2103, as affordability constraints due to real wages growing less than rents had exerted a brake on rent rises, as well as the increased availability of mortgage finance which has allowed some former renters to purchase.

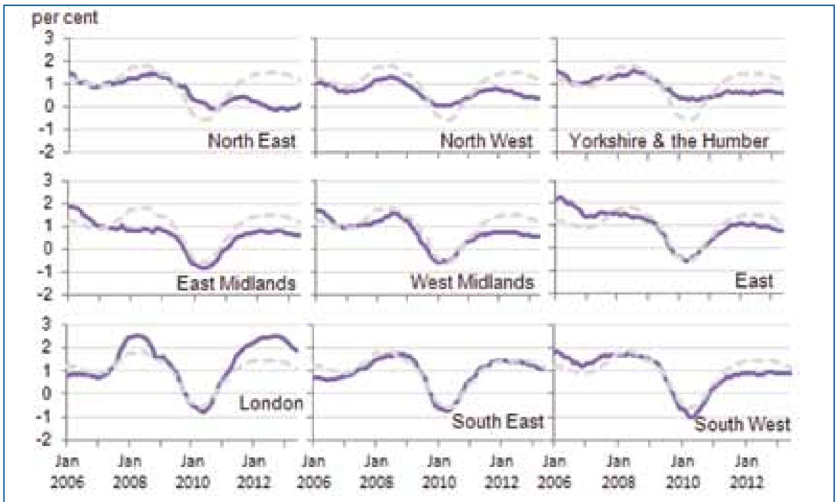
The Office of National Statistics have an experimental rental index that shows the regional disparity in annual changes in rents by English regions over the last 12 months and between 2006 and 2013 (Figure 2.6 and Figure 2.7) (ONS, 2013). Using these data the significant falls in rental income since the recession remain pronounced in the northern regions. More recently, despite media reports of significant rises, any rent increases in the ONS data have been modest, and although more significant in London, do not seem to reflect a profound change overall.

Figure 2.6: IPHRP Change over 12 months by English region August 2012-2013



Source: IPHRP ONS

Figure 2.7: IPHRP Change over 12 months by English region 2006 to2013



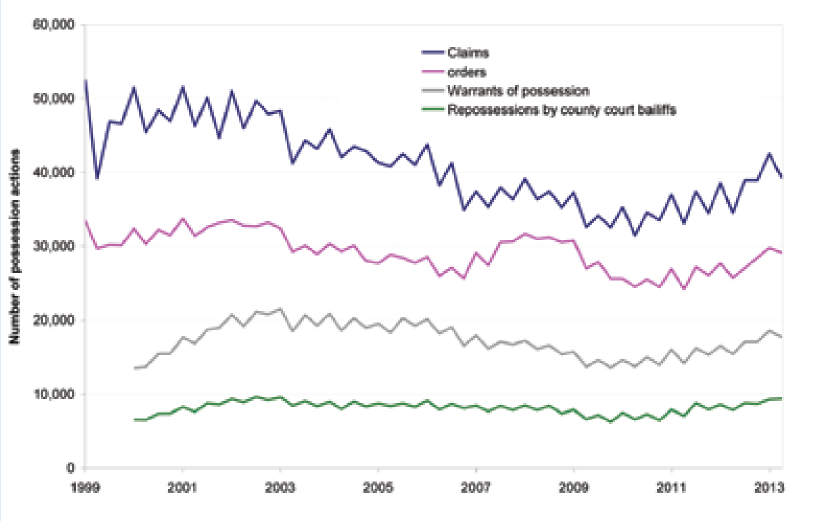
Source: IPHRP ONS (darker line=region; broken line= average for England)

Aside from rent levels the propensity of tenants to pay the rent is also intuitively a key influence on the financial pressures on landlords, but the evidence on tenant rent arrears is slightly unclear. The ability or willingness of tenants to pay the rent may be influenced by the local economy, and/or it may relate to policy risks and the ease of obtaining local housing allowance or housing benefit, which is discussed below.

The incidence of landlords seeking possession in county courts on the grounds of rent arrears is an indicator of trends in this area and represented in Figure 2.8. However, two caveats exist; firstly, these data include social rented sector landlords as well as private landlords, and secondly, not all landlords may pursue formal litigation in the county courts as a redress for rent arrears, but choose to end the tenancy when it expires using section 21[2] (Ministry of Justice, 2013). These data show that the number of landlord possession claims in County Courts fell during the period 2003 to 2008, but increased since 2010 by 29 per cent to 45,000 in the third quarter of 2013. This pattern of a reduction in landlord claims for possession up to 2010 and subsequent rise has been similar across all regions.

2 Under the Housing Act 1988 Section 21 gives a landlord an automatic right of possession without having to give any grounds (reasons) once the fixed term has expired.

Figure 2.8: Landlord possession claims in the County Courts



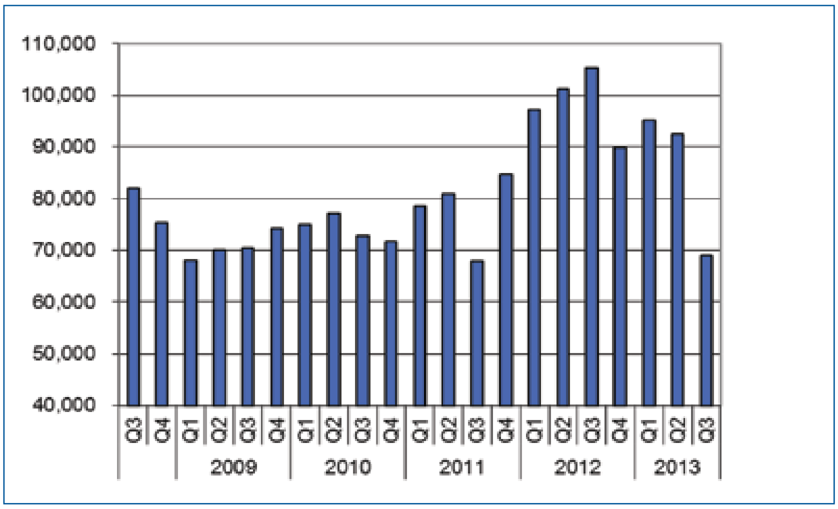
Source: Ministry of Justice

Templeton LPA/LSL Property Services also provide a track of private tenants in severe rent arrears- here defined as two months or more (LSL Property Services, 2013) (Figure 2.9). Templeton/LSL data shows some volatility, with tenants in serious arrears reaching a peak in 2012 and then falling subsequently. By Q3-2013 serious rent arrears affected 1.7 per cent of all tenancies, and represented a fall of 34 per cent from Q3-2012. The LSL Buy-to-Let Index shows the proportion of private tenants in any arrears at 7.1 per cent in October 2013, which they report as being the lowest since their records began in 2008 when 13.1 per cent of tenants were in arrears. Similarly, BDRC (2013) report that the proportion of landlords reporting tenant arrears declined from 63 per cent to 51 per cent between 2012 and 2013.

Landlord's rental income is also affected by the number and length of void periods experienced. Landlords Survey data from BDRC and the National Landlords Association in March 2013 suggests that a third of landlords had experienced a vacant period within the last 12 months, a decline of 13 per cent from the previous year (National Landlords Association, 2013a). There were significant regional differences with 54 per cent of North East landlords experiencing voids, compared to only 20 per cent of London landlords.

This aggregate market evidence is mixed but private market data suggests an improving situation in terms of tenants filling vacant property and meeting rental commitments. What is not clear from these data, however, is to what extent and how the incidence of tenant rent arrears or voids may flow into landlords' mortgage arrears, not least as best practice is to build in void periods and additional management and maintenance costs to the business model. Moreover, it is also uncertain whether reductions in tenant rent arrears reflects an increasing ability of tenants to meet their rent as the economy improves, or a shift in landlords' letting behaviour in accepting less risky tenants.

Figure 2.9: Tenants in two months or more rent arrears

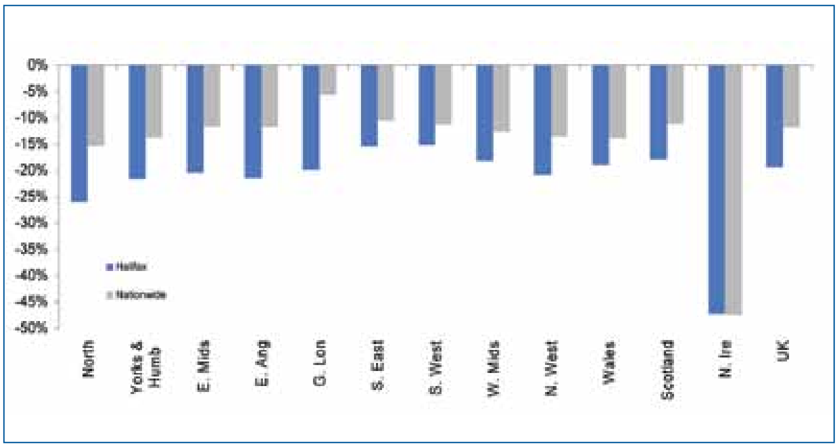


Source: LSL/Templeton LPS

House prices

Landlords are also at risk of house price depreciation. As the prospect of capital gains over the long-term sits behind many motivations for buy-to-let, short term fluctuations in house prices may influence the decisions to sell properties and exit the sector. House price falls or negative equity may not be problematic if the landlord has no intention of selling. However, negative equity may influence the landlords' ability to extricate themselves from any adverse impacts of market changes on their rental investment, as they would incur a shortfall debt to the lender if they sold the property. Figure 2.10 depicts the incidence of negative equity across the UK for residential mortgages between 2007 and 2011. It shows that negative equity was by far the most widespread in Northern Ireland, but also high in the northern regions of England, and in Scotland and Wales. House prices have increased slightly since 2011 so negative equity may have declined or even diminished in some locations, however, house price growth is uneven and the regional disparities will remain.

Figure 2.10: Negative equity by region 2007-2011



Source: Purdey (2011)

Anecdotally, some housing sub-markets have been disproportionately affected by negative equity. Buy-to-let and city centre apartment markets were considered to have been badly affected as oversupply was widely recognised (French and Leyshon, 2009). As the housing market changed abruptly from 2008 there were reports of negative equity in these sectors but empirical evidence is difficult to obtain. Standard and Poor estimated that almost half of buy-to-let property investors would suffer negative equity, compared to only 14-20 per cent of residential borrowers (Property Wire, 2008). Negative equity was also due to valuations inflated beyond what the market could sustain by the incentives and opaque discounting deals offered by developers to prospective purchasers - often skewed towards investors - on new-build properties (CML, 2011).

So whether buy-to-let properties are more or less subject to negative equity, the phenomenon's relationship to mortgage arrears is uncertain. The CML guards against any association between negative equity and mortgage arrears in the residential market (Tatch, 2009), but whether landlords make strategic default decisions when their buy-to-let investment, i.e. not their residential home, declines in value is unknown.

Mortgage costs

Mortgage costs may also be considered as much a policy risk as a market risk as low base rates and prudential approach to further lending in the market are arguably as much a result of policy decisions as a response to market events. In either case, mortgage costs represent an external risk over which a landlord will have limited control.

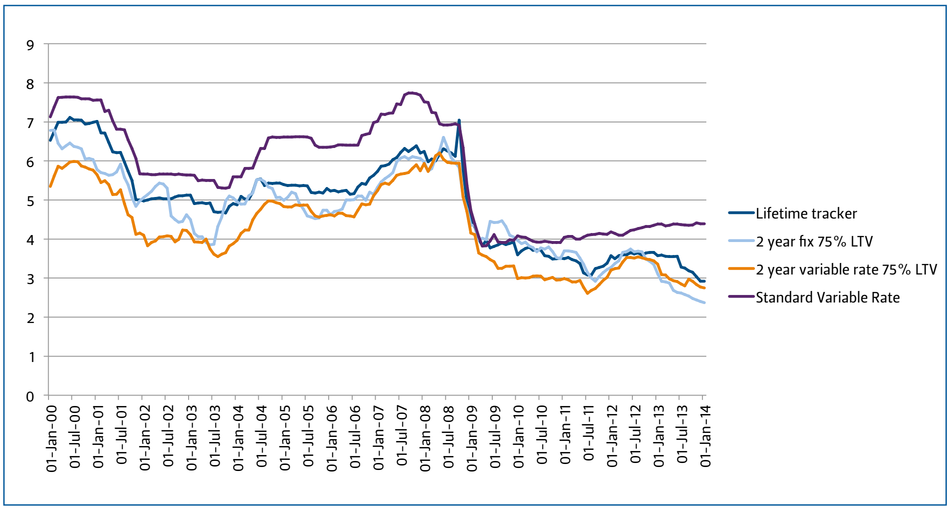
The costs of borrowing have changed dramatically over the last decade, and obviously have a bearing on the sustainability of a buy-to-let mortgage. Neither the Bank of England nor the Financial Conduct Authority have published typical mortgage rates for buy-to-let loans, but Figure 2.11 illustrates how mortgage rates in the residential market have changed, showing typical rates for various types of loans throughout the market cycle. Borrowers on tracker and variable rates were able to reduce their mortgage payments substantially, limiting the incidence of arrears and possession in comparison to the market downturn in the 1990s (Ford and Wallace, 2009). In contrast, borrowers on fixed rate loans were the least able to take advantage of the fall in Bank of England base rates from November 2008, until their loans reverted to the standard variable rate, which following the financial crisis has moved closer to the rates elsewhere in the market.

The term 'Mortgage prisoners' has been coined to describe borrowers unable to remortgage to secure more advantageous interest rates as they no longer meet the most stringent criteria required for lending post the financial crisis (FSA, 2012). Not all borrowers unable to remortgage are on the highest rates, as some may have gone on to standard variable rates, but the FSA estimated that 45 per cent of borrowers in 2012 may have been unable to switch deals.

Again no data is available for buy-to-let loans but landlord borrowers may find remortgaging difficult as the criteria to obtain loans has changed. The market has reduced the maximum loan-to-values in particular, with typical LTVs at 75 per cent since 2009, compared to 85 per cent up to 2008 and 80 per cent during 2008 (CML Table MM6). The maximum number of properties a landlord can hold has also changed, and the maximum loan ceiling any one investor can hold has reduced from £3 million during 2008-2009 to £1-1.25 million during 2013.

The percentage rental cover required has remained largely the same at 125 per cent throughout the market downturn, although products with lower rental cover were available during the market peak. Across the piece, these changes suggest that landlords with mounting payment difficulties will be unable to switch mortgage deals to reduce outgoings.

Figure 2.11: Residential regulated mortgage rates by year 2005 to 2012



Source: Financial Services Authority (2012)

Bank of England base rates moved to the historic low of 0.5 per cent in 2009 and since then the prospect of rising interest rates has been a significant concern. At the time of writing the Governor of the Bank of England signalled that any UK economic recovery must be sustainable and balanced prior to any rate rises being implemented, allaying fears of any short-term movement in interest rates. Although new residential borrowers of regulated mortgages will be subject to stress testing and affordability checks and should therefore cope better with any rises, existing loans and buy-to-let loans may not. The BDRC Landlords Survey (BDRC, 2013) reports that 10 per cent of landlords strongly agreed and 28 per cent agreed with a statement that they were worried about their ability to pay if mortgage costs were to rise.

Business risks

Landlords have multiple motivations to let property, but several studies indicate that few are professional full-time landlords. A majority let property as a side-line for medium- to long-term investment purposes, notably as part of their retirement plan, reflecting the decline in trust and returns from other assets (Rhodes and Bevan, 2003; Gibb and Naysgaard, 2009, Rugg and Rhodes, 2008; Jones la Salle, 2012).

The management and expertise of some involved in landlord and letting activities has been questioned (Crook *et al.*, 2009; Rugg and Rhodes, 2008). Most concerns centre on the landlords or agents' awareness of their obligations or competence, and even sharp practices, in respect of their letting, rent setting, arranging tenancies and organising repairs. In some instances, informal practices may favour the tenants (Rugg and Rhodes, 2008), but a less codified approach to the business of being a landlord that lacks professionalism, may also mean that landlords are not attuned to changes in the market that could be to their own detriment.

The reliance on rapid capital growth rather than rental income led Leyshon and French (2009) to note that less than a third of landlords had sustainable business models for their letting activities. This dependence on capital appreciation meant that there were concerns regarding the impact of any market downturn on the burgeoning buy-to-let sector and fears that falling capital values in the housing market could prompt large movements out of the market. However, evidence prior to the financial crisis showed that landlords were investing for the long term (CML, 2004). Scanlon and Whitehead (2005) argued that landlords could withstand adverse impacts and that buy-to-let could have a stabilising effect on the market, but that they would exit if interest rates rose and if the rental income did not cover the mortgage. Furthermore, Rhodes and Bevan (2003) also found, even at that time, a small proportion of landlords quite heavily subsidising their rental portfolio or property from their own income, a minority who would be at greater risk in the event of a downturn. While landlords with fewer properties considered capital growth as a compensation for poor rental income in these circumstances, professional landlords with property portfolios believed that rental income should always cover the mortgage and the associated costs of letting, exposing a divergence in approaches among landlords and a weakness in the small investor sideline landlord model.

Buy-to-let landlords do have greater personal resources than the wider population and Lord *et al.* (2013) suggest that they are therefore financially resilient and can cope with substantial income shocks. Several studies do demonstrate that landlords are indeed typically older, wealthier, well-educated, higher rate taxpayers, with significant savings and disproportionately living in London and the South East (Lord, 2013; FSA, 2012; Beatty *et al.*, 2012). Weaknesses in the financial circumstances of some landlords are, however, evident. BDRC (2013) found 13 per cent of small landlords, who form the majority of the market, were making a loss at Q3-2013 from their landlord activities, although this was down from the 16 per cent on Q2-2012. Looking closely at the Lord *et al.* (2013) analysis of the Wealth and Assets Survey indicates a minority of financially stressed landlords, who are, nevertheless, responsible for a significant portion of private rented homes. For example, 14 per cent of landlords felt the rental income was not sufficient to meet the cost of everyday outgoings; 11 per cent would have to borrow money and 17 per cent would use a credit card or overdraft to meet an unexpected major expenditure; and 16 per cent could not cope for three months if their income dropped by a quarter. Not all landlords struggling financially will accrue arrears but these data are indicators of financial stress. Although buy-to-let is intrinsically tied up with personal financial investments, as a business proposition lenders expect it to 'wash its face' or be self-financing. Although, Lord *et al.* highlighted other conclusions, their study does indicate that a minority of landlords lack the resources to support adverse events within their buy-to-let business activities.

Policy risks

In addition to changing wider economic or market factors, policy and regulatory changes may also exert pressure on landlords' finances. The most high profile change over the last decade have been the changes to housing benefit, which affects the tenants' ability to meet their rent commitments.

Housing benefit for private tenants was reformed from 2008 onwards and a local housing allowance paid. No longer tied to the rent charged, allowances were based on flat rates applicable to different size properties and the drive was to increase tenants' personal financial responsibility by making payments to the tenant for them to pass onto their landlord. Prior to this it had become common practice for landlords and tenants to agree that housing benefit could be paid directly to the landlords. Further changes to housing benefit were made from 2011 onwards:

- Payments routinely paid to tenants not landlords directly (April 2008)
- Maximum local housing allowance reduced from 50 percentile local rents to 30 percentile (April 2011)
- The single room rate previously applicable to people aged under 25 was extended to people aged under 35, meaning people between the ages of 25 and 34 would no longer receive benefit to cover a one bedroom accommodation, only for a room in a shared house (January 2012)
- Caps on the maximum amounts of local housing allowances in each area, and a removal of a five bedroom rate (April 2013)
- A cap on the total amount of benefits an applicant can receive at £500 per week for parents and £350 per week for single people, which affects larger families and/or families in high rental areas (April-October 2013)
- The use of sanctions designed to induce changes in claimant behaviour – temporary disqualifications from benefits or amounts deducted from entitlements for certain periods – has also expanded

An interim analysis of the impact of recent changes to the local housing allowance found that landlords who let in areas dominated by the local housing allowance market were experiencing pressures on their loan repayments due to a combination of an inability to attract alternative tenants, declining rents, limited ability to increase rents and high mortgage costs and they feared a rise in interest rates (Beatty *et al.*, 2012; 2013). However, landlords did note that they could not wholly attribute adverse impacts and increased arrears in the housing benefit market to the changes in the local housing allowance as tenants were also subject to the much broader 'squeeze' on households' finances apparent during this downturn. The analysis also highlighted the spatial impacts of the policy changes, with the greatest reductions in tenants' entitlements being in the London and other high cost areas, such as Cambridge and York. In some lower cost areas, the tenants had been able to get the landlords to absorb these reductions in housing benefits, but in higher cost areas there was some evidence of landlords reducing their lets to tenants in receipt of housing benefit as alternative tenants were available. The BDRC Landlords Survey (2013) does indicate a substantial reduction in the proportion of landlords willing to let to tenants in receipt of local housing allowance from 46 per cent in 2010 to 22 per cent in 2013.

Beatty *et al.* (2013) also report that some landlords were nervous about the introduction of Universal Credit, the new benefit that will see the majority of social security benefits rolled into a single payment. Landlords viewed it as the end of a discrete housing allowance and perceived risks to their rental stream. A survey of landlords by the National Landlords Association (2013b) found that 70 per cent of landlords with tenants in receipt of housing benefit are concerned about the changes. Currently, landlords must wait 8 weeks of non-payment of rent before requesting payments be switched from the tenant to the landlord. Under Universal Credit, a review process will start earlier regarding the tenants' ability to manage their payments, after just four weeks rent arrears, and payments of the housing element of Universal Credit will revert to the landlords after 8 weeks, so landlords' perceptions of additional risks may be unwarranted. Provision to pay the housing element to landlords directly from the outset for households deemed vulnerable in terms of the guidance and regulations and those unable to manage money will remain. The roll-out of Universal Credit is not anticipated to be complete until 2017, so the full impact of the changes will be unknown for some time.

Since 2006 landlords of Houses in Multiple Occupation have been required to be licensed by law (BRE, 2010). Criteria for entry and operation under these local schemes vary, but often involve a cost to the landlord for a permit and possibly the costs of upgrading the property to meet certain standards. The increasing importance of the private rented sector to the housing market has prompted further calls to reform the sector, to improve the quality of management, maintenance and offer stable renting (Rugg and Rhodes, 2008; Shelter, 2011). Several local authorities and devolved regions are now operating accreditation and local licensing schemes for all landlords, regardless of the type of properties let. The impact of local licensing arrangements and any associated costs on landlords' finances is uncertain.

As mentioned, policy and practice in respect of offering tenants longer tenancies is evolving. Two recent reports consider the potential impact of longer tenancies on landlords' business models, addressing assumptions that greater tenant security would jeopardise landlords' business plans. Lloyd (2013) argues that as landlords are on the whole evidently wealthier than the wider population they can sustain a strengthening of tenants' rights, through innovations such as longer tenancies, even if it reduces profitability and that if such rights were enacted that landlords would not exit the sector in significant numbers. Lloyd's report was based on Lord *et al.*'s (2013) analysis of landlords' personal financial circumstances not their business finances, but Jones La Salle (2013) used data from eight case study landlords to model the impact of longer tenancies on landlords' business plans and found that their returns would be enhanced by longer stable tenancies.

Conclusions

The stock of buy-to-let mortgage arrears has fallen at a sharper rate than arrears in the residential mortgage market, but the proportion of loans subject to possession in the buy-to-let market has been in excess of the residential market. The extent to which personal rather than business or market factors emerge as significant triggers for mortgage arrears in the residential market – unemployment, ill health or relationship breakdown- are also factors in landlords' accounts of their mortgage arrears is unknown. Buy-to-let is, however, formulated by lenders and regulators as a self-supporting business enterprise so in theory should not be affected by these events. Little is known about the determinants of buy-to-let landlord arrears but we can speculate about some of the pressures landlords may face. There has been some volatility in the rent levels, vacant periods, and house price values throughout the market downturn and significant regional differences are evident that may affect landlords' ability to sustain their mortgage payments. The landlords' experiences seem to be improving but the evidence suggests a small pool of financially precarious landlords. The next chapter examines evidence from the English Housing Survey, which reflects a cross-section of the market experiences during 2009-2010. The analysis provides an overview of landlords' circumstances and the factors associated with problematic mortgage costs.

3: Evidence from the English Housing Survey Private Sector Landlords Survey 2010

Summary

- Over a fifth of landlords in the 2010 English Housing Survey Private Landlords Survey reported problems with their mortgage costs. A total of 16 per cent reported small problems with mortgage costs and six per cent reported serious problems.
- Letting in areas with selective licensing schemes was significantly associated with landlords reporting mortgage cost problems but fell away as an explanation for problems after further analysis. This suggests that licensing reflects by proxy the types of neighbourhoods, lettings and experiences subject to these schemes.
- Tenants being in receipt of housing benefit were associated with tenant rent arrears but, at the time of this survey, there was no association with landlords losing money as a result. Moreover, the mechanism by which housing benefit may have contributed to tenant arrears at this time was unclear, as there was no association between rent arrears and shortfalls in housing benefit payments, or with tenants receiving the benefit directly.
- As housing benefit administration problems were significantly associated with landlords reporting mortgage cost problems it could be that administrative delays, payment in arrears and/or problems with reclaiming overpayments from landlords were the core issues concerning landlords during 2009-2010 when the data was collected.
- The most significant factors that increased the odds of a landlord reporting problems with their mortgage costs were letting property in the North East, and reporting problems with finding builders, tenant damage, local housing benefit administration, deposit disputes and asking tenants to provide a reference. These factors reflect market conditions in some locations, policy issues in respect of housing benefit administration and business risks in respect of managing tenancies.
- These factors account for a quarter of the variance of landlords reporting problems with their mortgage costs, suggesting that other factors unobserved in the data are also important.

Introduction

This chapter presents the findings of the analysis of the English Housing Survey Private Landlords Survey (EHS-PLS 2010). As mentioned in the first chapter, these data were collected during 2009-2010 since when the economic, housing and mortgage market indicators have changed. In addition, social security policy in respect of housing benefit has been further amended, which has the capacity to disrupt landlords' finances if housing benefit no longer covers the rent, for example. The EHS-PLS data nevertheless represent a robust portrait of landlords' circumstances, experiences and attitudes towards their letting activities and mortgage costs.

The next section provides an overview of landlords and their letting activities across the whole market, and then continues by examining the attributes of landlords and tenants who are identified as having an outstanding mortgage or loan and are associated with problematic mortgage costs. The final section presents the findings of the statistical analysis that identifies those factors that increase the odds of landlords reporting problematic mortgage costs. The analysis shows a wide range of factors that, taken as a whole, could suggest that landlords reporting problems with their mortgage costs is associated with letting to individuals or locations in some disadvantage.

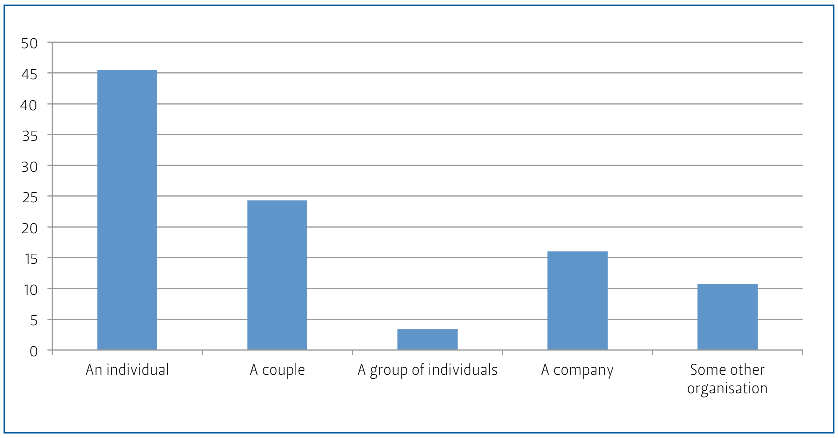
Profile of landlords

Landlord characteristics

A total of 73 per cent of landlords are individuals, couples or groups of individuals, compared to 27 per cent that are a company or other organisation (Figure 3.1).

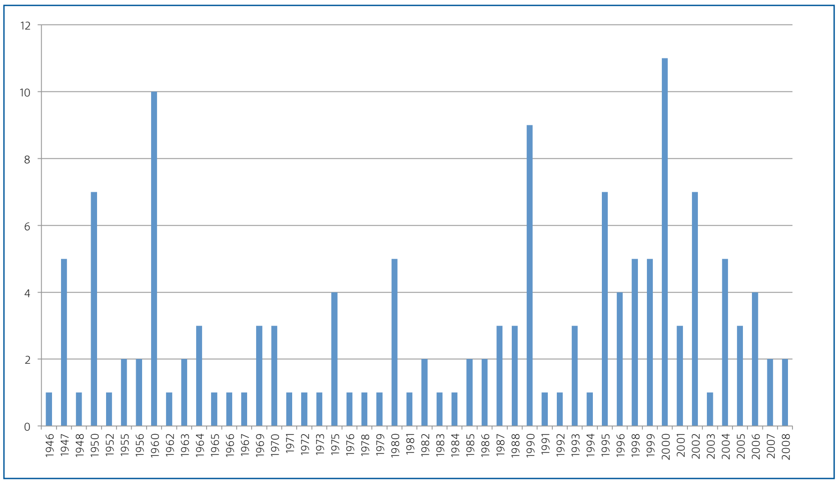
Companies have been in the letting market consistently over time, but there has been substantial change in the entry of individual landlords to the market, with some notable spikes after the Housing Act 1988, that introduced shorthold assured tenancies and rent deregulation; following the advent of buy-to-let mortgages in 1996; and during the rising property markets of the 2000s (Figure 3.2 and Figure 3.3).

Figure 3.1: Type of landlord (%) (n=1050)



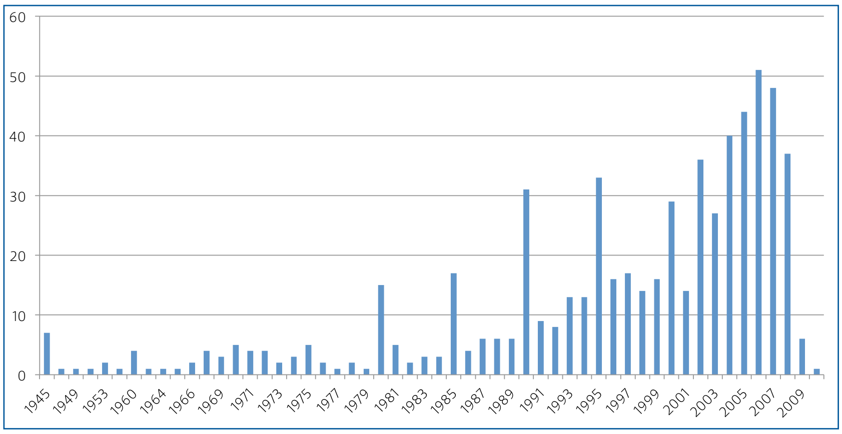
Source: EHS-PLS 2010

Figure 3.2: Year companies started



Source: EHS-PLS 2010 (n=209)
NB 1945 or before

Figure 3.3: Year individuals started letting letting

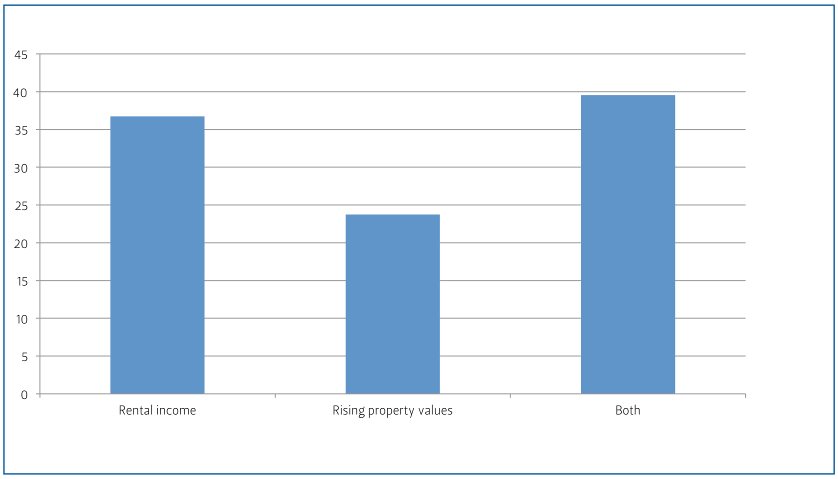


Source: EHS-PLS 2010 (n=638)

Eleven per cent of landlords work in property or estate management and 26 per cent in the building or maintenance trade. A fifth (21 per cent) hold a qualification in finance, property, building or the law. A fifth of individual landlords (19 per cent) also say letting is their main business, compared to almost half of companies (48 per cent). Half of all landlords are members of a professional organisation, compared to 59 per cent of company landlords and 46 per cent of individuals.

Two-fifths of landlords consider both rental income and rising property values as important to their investment strategy (Figure 3.4). Rental income is the sole priority for only 35 per cent of landlords, and capital values the sole motivation for nearly a quarter of investors.

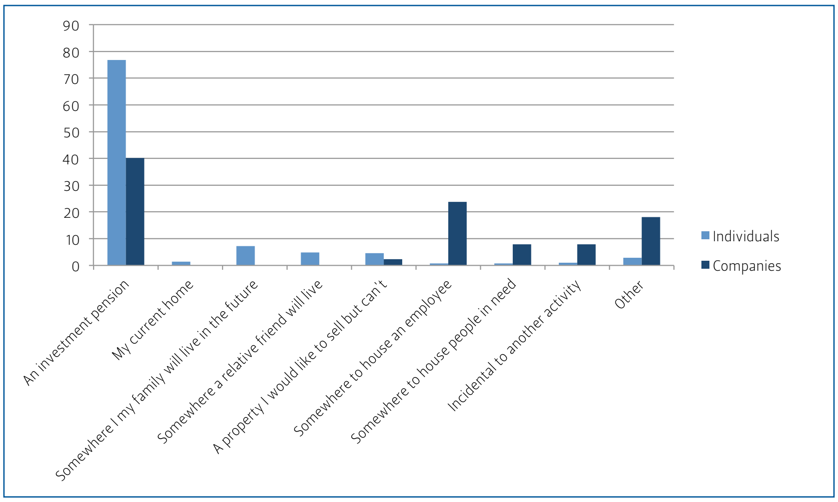
Figure 3.4: Landlords' investment priority (n=659)



Source: EHS_PLS 2010

Around two-thirds of all landlords regard their property as a pension investment, but a third of all landlords hold property for other purposes. Individuals overwhelmingly regard their letting activities as an investment for pension purposes (77 per cent), and although this is important to companies too (40 per cent), companies also let property to house employees and for other reasons (Figure 3.5).

Figure 3.5: How landlords regard their property (n=754)

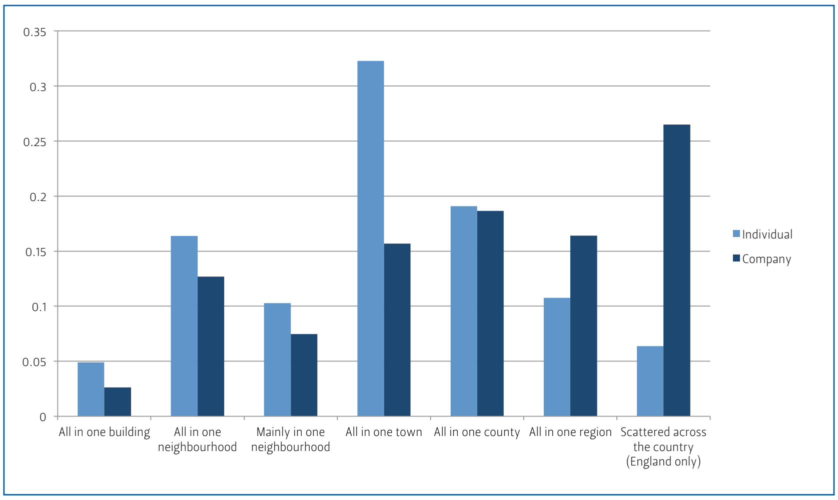


Source: EHS-PLS 2010

Property and location

In some respects, landlords with larger portfolios can spread their risks. Two-thirds of all landlords identified through the survey let more than one property (66 per cent) and 34 per cent only a single property. Fifty-five per cent of individual landlords let more than one property, compared to 96 per cent of companies. The mean number of properties held by individuals with more than one property is 18 and 261 by companies, although the median number of properties held is lower at 5 and 82 properties respectively. Individual landlords are more likely to cluster their properties in one town when compared to companies who are more likely to hold stock across different locations (Figure 3.6).

Figure 3.6: Location of properties (n=677)

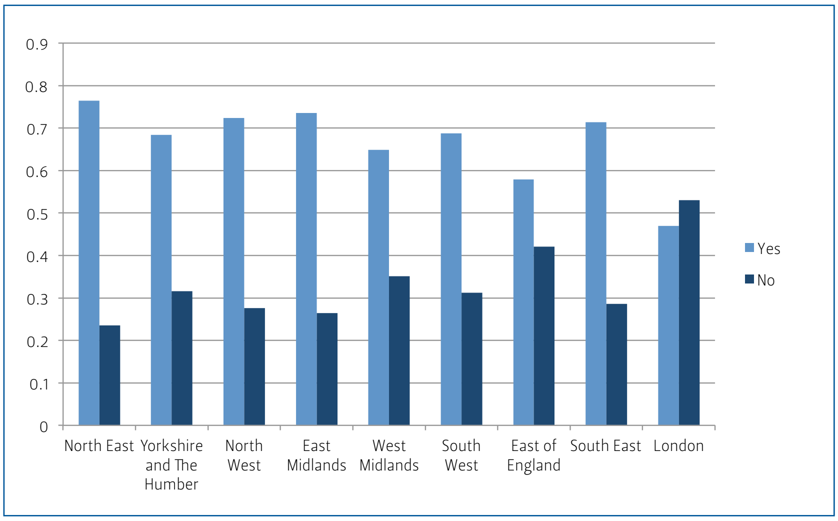


Source: EHS-PLS 2010

Most landlords (74 per cent) bought the property, but 11 per cent inherited it and nine per cent had it built. A total of 77 per cent of all landlords intended to rent property from the start. The majority (68 per cent) of all landlords let houses rather than flats (31.5 per cent) and very few let rooms only (one per cent).

Greater proportions of landlords own more than one property in regions other than London and the East of England (Figure 3.7). In London most landlords let a single property (53 per cent) compared to the North East, where only 24 per cent of landlords let only one property. Landlords' own home region is not identified within the EHS_PLS, so the proportion of landlords who let at a distance is unknown.

Figure 3.7: Landlords' properties by region (n=767)



Source: EHS_PLS 2010

Business Risks

This section explores how landlords operate their letting activities, how they seek to select stable tenants and minimise risks during the period of the tenancy. Firstly, how landlords let and manage their properties is examined, followed by their willingness to let to different tenant groups, their approach to taking deposits and requesting references and their attitudes to managing properties and the issues that landlords considered to be the greatest problems.

Use of agents

For time-pressed or inexperienced landlords using an agent to let and/or manage the property may reduce their business risks.

Most landlords let and manage the properties themselves. Almost a third of landlords use an agent to find a tenant (30 per cent) and landlords with single properties are more likely to use agents to find the tenant (35 per cent) than companies (14 per cent). There was no difference between the proportion of individual landlords, companies or those with single or multiple properties who used an agent to manage the property (12 per cent).

A total of 83 per cent of landlords who responded to the question were satisfied with their agent, and 117 of the 137 responses were by landlords with more than one property. There are too few responses to identify any significant differences between the experiences of landlords in different regions or between landlords with one or more properties. The attitudes of landlords who do not use letting agents is also omitted from the survey.

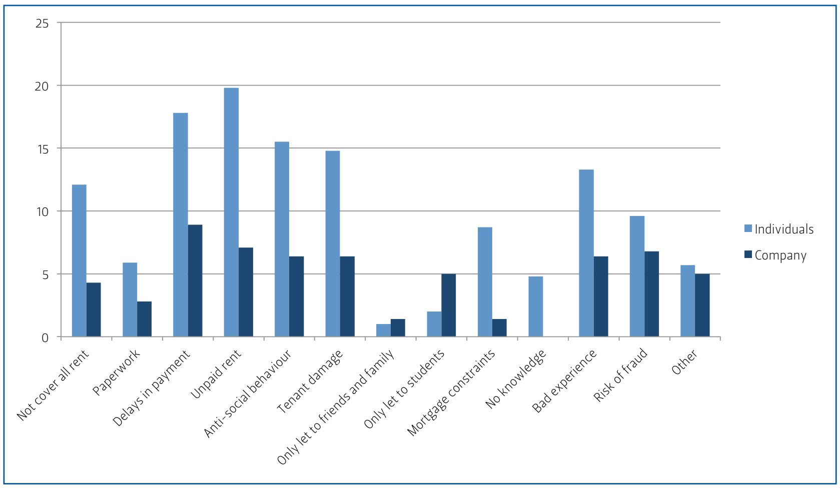
The numbers are small but there was a significant association between the use of agents to manage and to let properties and the *increased* frequency that landlords reported disputes about deposits, although the reason is unclear. However, the proportion of landlords using agents to let properties was associated with a lower proportion of landlords reporting serious problems with housing benefit administration as well as serious problems with tenant arrears and debt. Using an agent to manage or let the property is not associated with landlords reporting tenant arrears in the last 12 months, but may relate to fewer landlords having tenants on housing benefit if they use letting agents to let properties. Ten percent of landlords who use an agent to let the property have a tenant in receipt of housing benefit, compared to 34 per cent of landlords who do not use an agent to let the property.

Target tenant groups

Housing benefit or local housing allowance allows households who would not otherwise be able to pay the rent to do so. Housing benefit is often considered problematic as the administration can be slow, it is automatically paid in arrears and because some people claiming housing benefit may be viewed as a greater risk for a variety of reasons.

At the time of the survey in 2009-2010, almost three-quarters of companies were happy to let to housing benefit recipients, but only 53 per cent of individual landlords. The reasons given for not letting to housing benefit recipients related to non-payment of rent or delayed payments, as well as fears of tenant damage and anti-social behaviour. These concerns were reported more frequently by individual landlords (Figure 3.8).

Figure 3.8: Landlords' reasons for not letting to housing benefit recipients. (n=1038)



Source: EHS_PLS 2010

Landlords report that one fifth (22 per cent) of their tenants was on housing benefit. At the time of the survey, in 49 per cent of cases the housing benefit was paid directly to the landlord[3] and in 46 per cent of cases the housing benefit did not cover the rent. Eleven per cent of landlords have experienced tenant arrears in the last 12 months, and 48 per cent of these cases involved tenants on housing benefit.

It appears, therefore that tenants on housing benefit had a much higher risk of being in arrears, but the reason behind this is unclear. There was no significant association between tenant arrears and whether the benefit was paid direct to the tenant or whether the tenant was required to pay the shortfall if the benefit paid did not cover the rent charged, possibly due to too few numbers in the sample. It is therefore unclear whether the tenant arrears relate to delays in initial housing benefit payments, overpayments or other reasons. There was also no association between the tenant being on housing benefit and the landlord reporting that they lost money as a result of tenants being in rent arrears in the last 12 months, suggesting the arrears may have been temporary and reflect that housing benefit is routinely paid in arrears. It could be that at the time of the survey, when the full impact of the local housing allowance change to direct payments to tenants had not been felt, the perceived risk of accepting housing benefit tenants was greater than the actual risk.

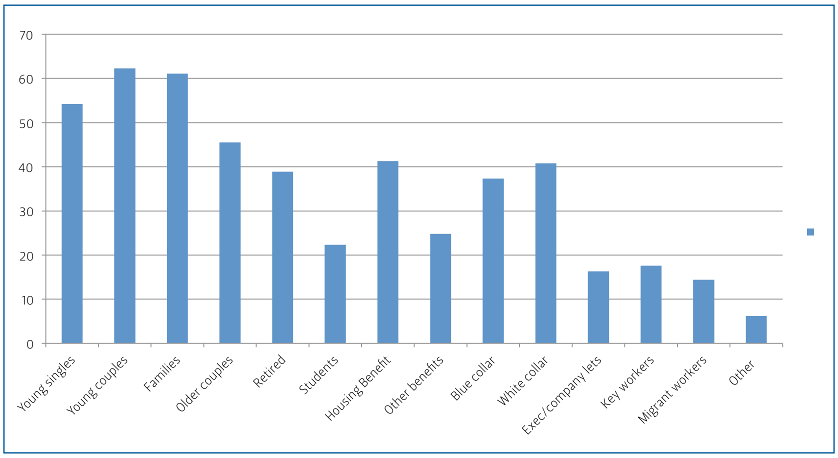
Landlords were also asked which groups of tenants they generally let properties to (Figure 3.9). Niche sectors in which fewer landlords were active were lets to students, company or corporate organisations, key workers and migrant workers. While 50 to 60 per cent of landlords let to families, couples and single people, a lower but still sizeable proportion (40 per cent) were *willing* to let to

3 These data relate to 2009-2010 when some transitional arrangements for claimants remained in place for those transferring from housing benefit to the new local housing allowance first introduced in 2008. The DWP suggest that by August 2013 only 29 per cent of private tenants in receipt of housing benefit have their benefit paid direct to their landlord (DWP Stat-Xplore accessed 21 January 2014).

tenants on housing benefit, although, as mentioned above, only 22 per cent actually had tenants in receipt of housing benefit at the time of the survey.

Just over a fifth of all landlords (22 per cent) let properties with multiple-occupants, 30 per cent of companies and 18 per cent of individual landlords. All landlords who let properties with multiple occupants were aware that they required a license to undertake that form of letting but while 86 per cent of companies with properties with multiple occupants had applied for a license, only 65 per cent of individual landlords who let this type of property had done so. Fourteen per cent of landlords were currently letting properties in an area with selective private sector licensing.

Figure 3.9: Landlords with multiple properties main tenant group (n=1050)



Source: EHS-PLS 2010

References and deposits

Landlords can minimise the risk of having a 'bad tenant' by requesting references and other checks on the reputation and credibility of the person. References from previous landlords or employers may be required, but landlords may also run credit checks on potential tenants. Deposits are commonly requested to cover the risks of tenants not paying the rent or causing damage to the property. These deposits may be equivalent to one or two months' rent or may take the form of a bond or guarantee from a charity or local authority. Landlords may also eschew the requirement for deposits and request that tenants provide a guarantor, a third party who would also be responsible for the rent and any other costs associated with the tenancy.

Individuals and landlords with a single property seem to adopt a more formal approach to letting than companies and those with multiple properties, which could relate to their confidence and experience in the market. Two-thirds of all landlords ask the tenant to provide a reference, but only 53 per cent of companies require references compared to 70 per cent of individuals and 63 per cent of landlords with more than one property compared to 70 per cent of those with a single property. The proportions of landlords who use agents and where tenants are asked to provide a reference are identical whether they are individuals or a company (92 per cent).

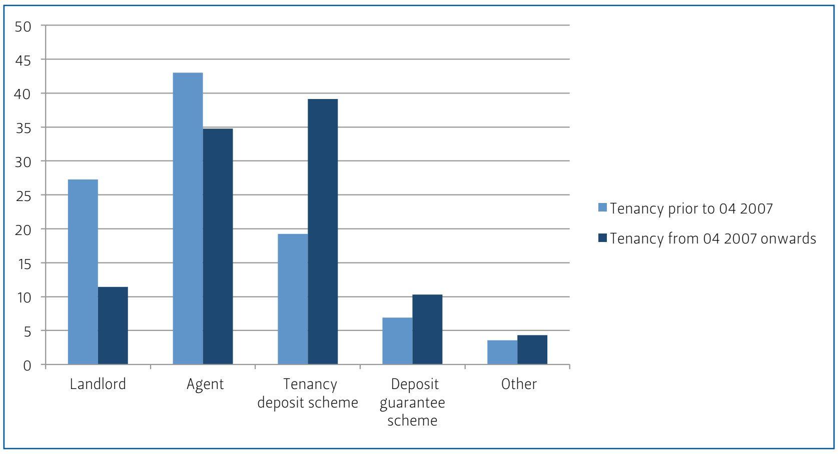
Seventy per cent of landlords require a deposit, but only 48 per cent of company landlords. A total of 18 per cent of landlords who request a deposit require a guarantor as well. Landlords who do not request a deposit were not asked if they require a guarantor instead. Two thirds of landlords with more than one property request deposits compared to 76 per cent of landlords with a single property. Landlords ask tenants on housing benefit for a deposit less frequently, 58 per cent of cases, compared to 85 per cent of cases where the tenant is not on housing benefit. Company landlords asked tenants on housing benefit for a deposit less frequently (46 per cent) than individuals (61 per cent). Eight per cent of landlords use a deposit guarantee scheme, often run by local charities, housing associations or councils.

Whether the different business practices were effective was unclear. There were no significant differences in respect of the rate at which landlords reported tenant rent arrears in the last 12 months or losing money as a result of tenant arrears between landlords with multiple or single properties or individual landlords or companies. Although conversely, this could mean that different risks were managed down to the same level.

There is less difference in the provision of formal tenancy agreements to tenants, as 92 per cent of all landlords provided a tenancy agreement, 88 per cent of companies and 94 per cent of individuals.

Eighty per cent of tenancies are assured shorthold tenancies, four per cent assured tenancies and three per cent regulated tenancies began prior to 1989. For assured shorthold tenancies after 6 April 2007 in England and Wales, landlords should use a government backed tenancy guarantee scheme to protect tenants' deposits. In this 2009-2010 survey data, a fifth of tenancies began in or after April 2007. Although the proportion of deposits held by agents and landlords is lower for lettings made after April 2007 than for lettings made prior to this date, only 39 per cent of tenants' deposits of lets made after April 2007 were held in a Tenancy Deposit Scheme (Figure 3.10).

Figure 3.10: Location tenant deposits held by start of tenancy. (n=719)



Source: EHS-PLS 2010

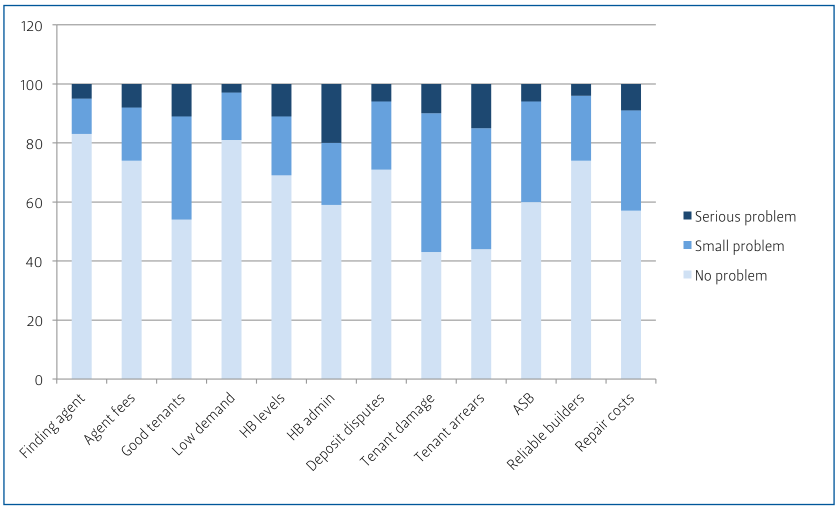
Of the landlords who have tenancies that started after April 2007, only 42 gave reasons as to why they do not use a deposit guarantee scheme. Fourteen said they do not request a deposit and 16 gave 'other' reasons. Seven said they ask for rent in advance instead.

Attitudes to managing properties

Landlords were asked how they would rate a number of issues relating to the management of their properties (Figure 3.11). The most common issues with which landlords reported as small problems were finding good tenants, tenant damage, tenant rent arrears, anti-social behaviour and repair costs. Issues that landlords reported as serious problems were local housing benefit administration and tenant rent arrears.

Some 11 per cent of landlords had experienced tenant rent arrears in the last 12 months, and 43 per cent of those had lost money as a result. There was no significant difference whether landlords who lost money as a result of tenants falling into arrears were a company or individual, nor if their tenant was on housing benefit. Tenant debts and arrears were serious problems for a greater proportion of landlords in the North East (24 per cent) and the North West (25 per cent) compared to only three per cent in the East of England.

Figure 3.11: Landlords rating of management issues (n=c.580)



Source: EHS-PLS 2010

Ten per cent of all landlords had serious problems with tenant damage to the property. Landlords who let property in the North East of England reported serious problems with tenant damage most frequently (25 per cent) compared to only one per cent in the East of England or four per cent in East Midlands and South West. In other regions between nine and 14 per cent of landlords reported serious problems with tenant damage to the property.

A total of 16 per cent of landlords considered mortgage costs to be a small problem and 6 per cent a serious problem, on par with deposit disputes and anti-social behaviour as issues that seriously concern landlords. The factors associated with landlords reporting problematic mortgage costs are discussed below.

Landlords with more than one property are more likely to report problems with finding good tenants, tenant damage, tenant arrears and debts, repair costs.

Tenant demand

Almost two-fifths of all landlords (39 per cent) had experienced vacant periods in the last 12 months. Of those landlords who had experienced tenant arrears, 53 per cent also experienced vacant periods, compared to only 14 per cent of landlords who had not had tenant rent arrears. The most common reasons for vacant periods were that the landlord could not find a suitable tenant (37 per cent) or that the property needed some work (29 per cent). Most tenants (80 per cent) gave one month or more notice of their intention to leave, and seven per cent between two weeks and a month. However, five per cent gave less than a fortnight and seven per cent no notice of their intention to leave. There were too few responses in each individual region regarding vacant periods to examine regional differences.

Repairs and maintenance

The condition of the property may affect tenant demand for the particular property or could influence the costs associated with repairs if they are undertaken.

Landlords appear to overstate the physical condition of their properties. Landlords rate the condition of their property as good or excellent in 83 per cent of cases, 15 per cent consider the property in fair condition, with only two per cent of landlords reporting that their property was in poor condition. However, the independent physical survey of landlords' properties conducted as part of the same EHS-PLS survey found that only between 52 and 66 per cent of properties met the decent homes standard using various measures[4]. This compares to 78 per cent of social housing that met the decent

4 For a dwelling to be considered 'decent' it must: meet the statutory minimum standard for housing (the Housing Health and Safety Rating System (HHSRS) since April 2006); not have any Category 1 hazards under the HHSRS; be in a reasonable state of repair; have reasonably modern facilities and services; and provide a reasonable degree of thermal comfort (CLG English Housing Survey Homes Report 2010).

homes standard during 2010 and 70 per cent in the owner-occupied sector (CLG, 2010). Nearly two-thirds (68 per cent) of all landlords had spent a £1000 or less on their property in the past year. A quarter had spent between £1000 and £5000 and seven per cent over £5000. However, landlords' expenditure on repairs was not significantly associated with the condition of the property.

Landlords were twice as likely to report that finding a good tenant was a serious problem if they estimated their property to be in a fair condition (18 per cent) compared to properties considered to be in a good condition (nine per cent).

Around a fifth (21 per cent) of all landlords reported that their tenants were on housing benefit, but tenants on housing benefit occupied a slightly greater proportion of properties rated by the landlords as fair (30 per cent) or poor (27 per cent). Housing benefit tenants were also slightly more likely to occupy a greater proportion of landlords' non-decent homes (24 per cent) compared to 17 per cent of the landlords' decent homes, although the difference is slightly smaller using alternative measures of decency.

This analysis shows that individual landlords, the majority of which only have one property, are later entrants to the market and adopt seemingly more formal procedures to limit business risks of letting properties. Individuals and single property landlords are more likely to use agents to find tenants, although a minority of landlords do this overall, and request references and deposits from tenants. Individual and single property landlords are also less inclined to let to tenant groups perceived as higher risk, such as tenants in receipt of housing benefit. Only in reducing the incidence of landlords reporting serious problems with tenant arrears do management agents and requesting a deposit prove effective in slightly reducing these risks, although this may be at the expense of a lower proportion of lets to tenants in receipt of housing benefit. Landlords did report more tenant arrears in the last 12 months in respect of tenants in receipt of housing benefit but there was no association with losing money as a result, so the reasons are unclear and could be structural in that housing benefit is paid in arrears. There are significant regional differences to the frequency in which landlords report problems relating to their lettings, with landlords letting property in the northern regions having substantially more serious problems with tenant damage or rent arrears, for example.

Factors associated with landlords reporting problems with mortgage costs

All landlords were asked if they considered their mortgage or loan costs to be a problem and a total of 971 landlords answered this question. It is unclear what proportion of these responses were from landlords who actually held an outstanding mortgage or loan as landlords were only asked if they had an outstanding mortgage or loan outstanding on their property if they were able to recall how and when the property was acquired. Of the 1051 landlords surveyed, a total of 754 landlords were able to answer this question. A total of 300 (40 per cent) of landlords were identified in this way of having an outstanding mortgage or loan on their property, but it is not known what proportion of the 297 landlords unable to answer the questions about their acquisition of the property satisfactorily also held mortgages, although it is likely that some did. There are too few landlords clearly identified as holding an outstanding mortgage or loan to assess what factors are associated with problematic mortgage costs, therefore, the analysis of factors associated with landlords reporting their mortgage or loan costs as problematic uses the whole sample. This will, therefore, include landlords who do not have a mortgage or loan, and who, it is assumed, will have responded that they do not rate their loan costs as problematic.

Before reporting on the results of this analysis, it is worth looking closer at the pool of landlords who did clearly hold a mortgage or loan. Some of the attributes of landlords with outstanding mortgages or loans are different to the attributes across the whole market. The vast majority of these landlords with an outstanding mortgage or loan were individuals (84 per cent), a slightly higher proportion than across all landlords (73 per cent). More than twice as many individual landlords with an outstanding mortgage or loan state that letting is their main business (47 per cent), compared to across the whole sample (19 per cent). The proportion of companies who have an outstanding mortgage or loan for whom letting is their main business (53 per cent) is broadly similar to the wider sample (48 per cent). A greater proportion of landlords with outstanding mortgages or loans state that their investment priority is rising property values (35 per cent) than across the whole sample (24 per cent). Agents are used to let and manage properties marginally more frequently by landlords who have outstanding mortgages or loans.

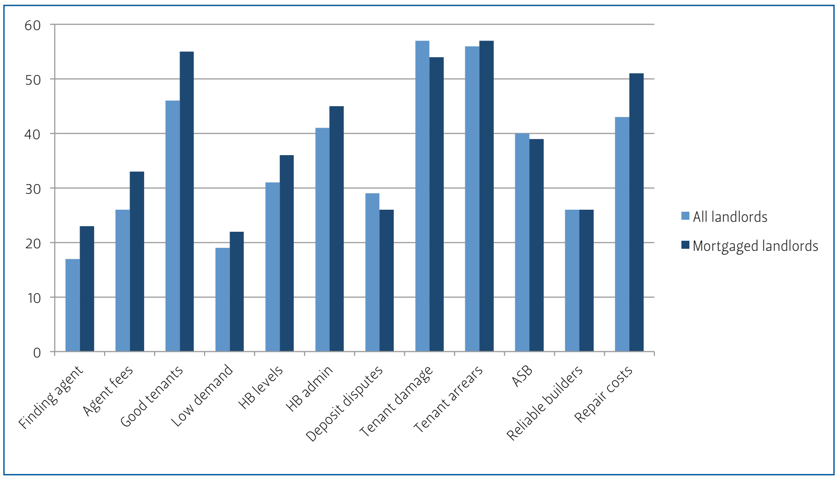
A total of 60 per cent of these landlords were willing to let to housing benefit tenants, which is slightly more than individual landlords across the whole sample, but still fewer than company landlords in the wider sample. A greater proportion of these landlords' tenants are in receipt of housing benefit, 30 per cent compared to 22 per cent across the wider sample of landlords. Landlords reported that housing benefit was paid directly to the landlord (52 per cent) and did not cover all of the rent (48 per cent) in similar proportions to the whole sample. Slightly more landlords with an outstanding mortgage or loan had experienced tenants falling into arrears within the last 12 months (16 per cent) than across the wider sample (11 per cent) and of these a greater proportion of tenants on housing benefit had fallen into arrears (57 per cent) compared to the whole sample (48 per cent). Again there was no significant association between tenants falling into arrears and benefit paid direct to the landlord, although the sample is much smaller in this instance.

Further attributes of landlords with an outstanding mortgage or loan are broadly similar to the wider market, such as the year they acquired property, the properties bought and whether landlords let more than one property or not.

Most of the landlords identified as having an outstanding mortgage or loan do not consider their mortgage a problem at all (63 per cent), but 11 per cent (31 landlords) rate their mortgage or loan repayments as a serious problem and a further 26 per cent (75 landlords) as a small problem. Unfortunately, the wider English Housing Survey asks slightly different questions of mortgagors in the residential market so direct comparison between residential mortgage borrowers and buy-to-let mortgage borrowers' attitudes towards their mortgage costs are difficult. However, 88.5 per cent of owner-occupiers reported that they had no difficulty in keeping up with their mortgage payments in the last 12 months, nine per cent reported that they had found it rather difficult and two per cent very difficult to keep up with payments. The owner-occupier question is more closely tied to keeping up with payments than the landlords' question, which could account for the lower proportion of owner-occupiers than landlords reporting difficulties.

Landlords rating of problems in their letting activities are generally higher among landlords with outstanding mortgages or loans (Figure 3.12).

Figure 3.12: Landlords rating of management problems by type of landlord (%)



Source: EHS-PLS 2010

Having considered how landlords clearly identified as having an outstanding mortgage or loan compare to the whole sample of landlords, this chapter continues, with the above caveats, by examining the factors that are associated with landlords reporting problems with their mortgage costs and which of these factors exerts the strongest influence.

Landlord attributes and perceptions

Table 3.1 shows the characteristics of all landlords' letting activities and experiences by whether they rate their mortgage or loan costs on their rented property as problematic, and where the association is not considered to be a result of chance alone. The table shows that the greatest proportion of landlords reporting serious problems with their mortgage costs was those landlords who also reported serious problems with: repair costs in the last year (22.2 per cent) and finding reliable builders or tradesmen (26.3 per cent), although the number of landlords who find these issues a problem overall is small. Other issues where above average rates of serious mortgage cost problems were also reported were landlords who currently let property in areas with selective licensing schemes (10 per cent), letting with furnished tenancies (nine per cent), began letting from 2001 onwards (nine per cent), letting property to multiple occupants (nine per cent), where letting was the landlords main business (eight per cent) and having undertaken repairs in the last 12 months (seven per cent).

Individual landlords are more likely than companies to report serious problems with mortgage or loan costs. While 18 per cent of individual landlords consider their mortgage costs a small problem, only nine per cent of companies report mortgage costs as a small problem. Similarly, seven per cent of individual landlords consider the mortgage costs to be a serious problem, compared to five per cent of company landlords, although the difference here is less pronounced. Agents responding on behalf of landlords are more likely to report mortgage and loan costs are a problem than landlords responding to the survey directly in this sample. There was little difference in landlords reporting problems with mortgage costs whether landlords had single or multiple properties.

Rents were slightly higher in cases where the landlords reported problems with mortgage costs, although it is difficult to know how to interpret this given that regions with lower cost housing markets have the greater incidence of landlords reporting serious problems with mortgage costs (see below). Average weekly rents charged by landlords were £123 for those who reported no problems with mortgage costs, £158 for those landlords who reported that mortgage costs were a small problem and £133 for landlords who had a serious problem with mortgage costs.

There was little difference between landlords who reported mortgage problems in the length of tenancy, the means differed slightly, but the median length of tenancy of two years was consistent for all landlords.

There were several issues that may have been assumed to be linked to problematic mortgage costs but where no significant association was found. These included the landlords' investment priorities, having vacant periods within the last 12 months, the condition of the property, using an agent for letting or managing the property, the property type, the proportion of income from rent, or whether the landlord worked full time in the property business (although letting as the landlords' *main* business was associated with mortgage cost problems but only at a slightly elevated rate).

Table 3.1: Landlords' letting activity by problems with mortgage costs

	How landlords rate the issue of mortgage/loan costs				
	No problem	Small problem	Serious problem	% all landlords	Count
All landlords with outstanding mortgage or loan	78.2	15.7	6.2	100	971
Single property	74.8	19.3	5.9	33.6	321
Multiple properties	79.8	13.2	6.3	66.4	634
Letting main business	80.6	11.7	7.7	26.5	248
Letting not main business	77.1	17.2	5.7	73.5	687
Respondent Landlord	80.4	13.2	6.4	69.4	674
Respondent Agent	73.1	21.2	5.7	30.6	297
Landlord Type:- • Individual	75.5	17.8	6.6	45.0	437
• Couple	73.6	20.0	6.4	24.2	235
• Group of Individuals	82.9	8.6 *	8.6 *	3.6*	35
• Company or organisation	86.0	9.1	4.9	27.2	264
Membership of professional organisation	75.3	19.3	5.5	47.3	457
Not member of professional organisation	80.6	12.5	6.9	52.7	510
Let properties in multiple occupation	67.3	24.2	8.5	21.5	153
Does not let properties in multiple occupation	77.0	16.1	6.1	78.5	559
Area of selective licensing	65.9	24.0	10.1	14.3	129
Letting not in area of selective licensing	78.0	14.3	5.9	85.7	774
Furnished tenancies	72.4	18.6	9.0	34.6	333
Unfurnished tenancies	81.4	14.0	4.6	65.4	629
Landlord *do not* ask references	84.5	10.3	5.3	35.5	341
Landlord ask for references	74.8	18.4	6.8	64.5	619
Landlords *do not* ask deposit	85.0	9.6	5.3	31.3	301
Landlords ask for a deposit	75.2	18.2	6.7	68.7	661
Landlords provide written tenancy agreement	76.9	16.4	6.7	91.7	883
Landlords *do not* written tenancy agreement	92.5	6.3	1.7	80	8.3
Landlord repairs last 12 months	75.2	17.5	7.3	68.1	646
Landlord had not repairs last 12 months	84.2	11.6	4.3	31.9	303
Rate repair costs a serious problem	54.4	23.3	22.2	9.3	90
Rate repair costs *not* a serious problem	80.6	14.9	4.5	90.7	881
Rate finding reliable builders a serious problem	55.3	18.4 *	26.3 *	3.9*	38
Rate finding reliable builders not a serious problem	79.1	15.6	5.4	96.1	932
Rate letting in area of low demand a serious problem	57.7	38.5*	3.8*	2.7*	26
Rate letting in area of low demand not a serious problem	78.6	15.1	6.3	97.3	936
Land acquired property • 1980 or before	83.4	13.2	3.4	39.1	380
• 1981-2000	79.0	14.1	6.9	28.4	276
• 2001 or after	71.1	20.0	8.9	32.4	315

Source: EHS-PLS 2010. Author analysis. All significant at 0.05 or below. Grey shade denotes above average- >7.0 % - serious problems with mortgage costs. *small numbers caution.

Tenant or tenant-associated attributes

Table 3.2 shows issues related to the tenants or their ability to pay and the incidence of landlords reporting problematic mortgage costs. It is clear the issues reported in this section produce some of the highest proportions of landlords that reported problems with mortgage costs when compared to the landlord and letting activity indicators reported above. Around a fifth of landlords that reported problems in finding a good tenant, tenant deposit disputes, tenant damage and anti-social behaviour, also had serious problems with mortgage costs, although these represented only between five and ten per cent of landlords.

A total of 12 per cent of landlords with a tenant on housing benefit reported serious problems with mortgage costs. Moreover, landlords who had serious problems with the housing benefit levels or administration in their area also had serious problems with mortgage costs, in 12.2 and 12.8 per cent of cases respectively.

Just over half of landlords with tenants on housing benefit had the benefit paid directly to them and a similar proportion reported that the benefit covered all of the rent, but these issues were not associated with problematic mortgage costs.

Of the landlords who report serious problems with housing benefit administration in their local area, 18 per cent reported tenants falling into arrears in the last 12 months. This compares to only nine per cent of landlords reporting tenant arrears in areas where landlords also considered housing benefit administration not to be a serious problem.

A full 46 per cent of landlords had problems finding good tenants, and this was associated with landlords also reporting problems with their mortgage costs. However, the method landlords used to find tenants was not significantly associated with landlords reporting mortgage costs problems. Only 31, or 3.2 per cent, of landlords reported obtaining tenants from local authority nomination arrangements, but this was also not significantly associated with problematic mortgage costs.

The reason the last tenancy ended was not significantly associated with problematic mortgage costs if the tenant wanted to move or if it was the end of the agreed period. However, if the last tenant had been asked to leave, this was significant and landlords reported serious problems with mortgage costs in 20.0 per cent of cases.

The tenants' household composition is significantly associated with whether the landlords reported problems with mortgage costs. Landlords of lone parent households have an increased likelihood of reporting serious problems with mortgage costs (13.3 per cent) and landlords of retired single people reported problems with mortgage costs the least with 90.1 per cent reporting no problems at all.

Landlords reported problems with mortgage costs if their tenant household reference person was neither working nor retired in 8.4 per cent of cases, but whether the household was workless was not significant. The occupational class of the tenant (NS-SEC classifications) was not significantly associated with problems with mortgage costs. Neither the age nor the sex of the tenant household reference person is associated with their landlords reporting problems with mortgage costs. Vulnerability, as defined by whether the household reference person receives a means tested or disability related benefit, is also not associated with problematic mortgage costs.

Table 3.2: Tenant associated attributes of landlords with an outstanding mortgage or loan by problems with mortgage or loan costs.

	How landlords rate the issue of mortgage/loan costs				
	No problem	Small problem	Serious problem	% all landlords	Count
All landlords with outstanding mortgage	78.2	15.7	6.2	92.4	971
Tenant arrears in the last 12 months	66.3	17.8	15.8	11.0	106
Tenant on housing benefit	71.6	16.4	12.0	22.0	198
Tenant *not* on housing benefit					
Rate finding good tenants a serious problem	59.0	20.0	21.0	10.9	105
Rate finding good tenants *not* a serious problem	80.6	15.1	4.3	89.1	862
Rate HB administration a serious problem	59.0	28.2	12.8	19.9	188
Rate HB administration *not* a serious problem	83.3	12.2	4.5	80.1	756
Rate HB levels a problem a serious problem	62.2	25.5	12.2	10.3	98
Rate HB levels a problem *not* a serious problem	80.2	14.2	5.5	89.7	850
Rate tenant deposit disputes a serious problem	47.3	32.7	20.0	5.7	56
Rate tenant deposit disputes *not* a serious problem	80.0	14.6	5.4	94.3	915
Rate issue of tenant damage a serious problem	49.5	27.8	22.7	10.0	97
Rate issue of tenant damage *not* a serious problem	81.4	14.3	4.3	90.0	874
Rate tenant arrears/debt a serious problem	55.9	25.9	18.2	14.7	143
Rate tenant arrears/debt *not* a serious problem	82.0	13.9	4.1	85.3	827
Rate issue of anti-social behaviour a serious problem	47.3	32.7	20.0	5.7	55
Rate issue of anti-social *not* as serious problem	80.0	14.6	5.3	94.3	916
Last tenant asked to leave	68.0	12.0	20.0	2.5	25
Household Composition- Couple under 60, no children	76.2	16.4	7.4	20.5	189
• Couple 60 or over	83.3	16.7	0.0	5.9	54
• Couple children	80.0	14.6	5.4	20.4	185
• Lone parent	67.6	19.0	13.3	11.4	105
• Multi person	72.9	21.5	5.6	15.6	114
• Single under 60	81.2	14.5	4.2	17.9	165
• Single 60 or over	90.1	6.2	3.7	8.8	81
Employment status – 1+ full time	78.7	15.4	5.9	58.4	539
• 1+ part time	79.2	14.3	6.5	8.3	77
• No work 1+ retired	88.0	9.4	2.6	12.7	117
• No work no retired	69.5	22.1	8.4	20.6	190

Source: EHS-PLS 2010. Author analysis. All significant at 0.05 or below. Grey shade denotes above average- >7.0 % - serious problems with mortgage costs.

Market risks

The most significant indicator of market risk is that of the region in which the rented property is located, and this is associated with landlords reporting problems with mortgage costs.

The regions with the lowest proportion of landlords reporting serious problems with mortgage costs are the South East (1.4 per cent), South West (3.3 per cent) and the East of England (4.3 per cent) (Table 1.2). The regions with the highest proportion of landlords reporting serious problems with mortgage costs are the North East (18.2 per cent) and the North West (10.6 per cent). London has the greatest proportion of landlords reporting that mortgage costs are a small problem (22.4 per cent), followed by the North East (21.2 per cent). The level of demand in local housing markets is not associated with landlords reporting problems with mortgage costs, although this may be due to small numbers.

The regional economic and population characteristics account for some regional disparities, for example, the proportions of tenants on housing benefit in each region differs significantly as does the proportion of households where no-one works and no one is retired, although lone parents are not significantly associated with regions in this sample.

Table 3.3: Problematic mortgage costs by Government Office Region (per cent)

N=729		North East	Yorks and Humber	North West	East Mids	West Mids	South West	East	South East	London	Total
Rate of Issue with Mortgage Costs	Serious problem	18.2	7.5	10.6	1.6	7.4	3.3	4.3	1.4	8.2	5.9
	Small problem	21.2	11.8	18.8	18.0	11.1	10.0	13.0	12.3	22.4	15.0
	Not a problem at all	60.6	80.6	70.6	80.3	81.5	86.7	82.6	86.3	69.4	79.1
Proportion of tenants on housing benefit		19.4	24.7	43.8	15.5	29.2	14.3	6.3	15.5	19.8	20.8
No one works no one retired		40.0	31.6	27.5	17.4	24.1	13.5	10.4	19.9	19.6	21.4
	Total	4.5	12.8	11.7	8.4	7.4	12.3	9.5	20.0	13.4	100.0

Source: EHS-PLS 2010 Author analysis Significant at >0.05

Which factors are most important in influencing problems with mortgage costs?

Logistic regression can be used to test which factors increase the odds of landlords reporting problems with their mortgage costs and compares binary categorical variables, or indicators that can elicit a 'yes' or 'no' answer, such as 'Property is in the North East'. The analysis is conducted twice, in the first model (Model 1) the dependent variable is the landlords' report of a *serious problem with mortgage costs*. In the second model (Model 2) the dependent variable is the landlords' report of *any problems with mortgage costs*. The analysis earlier in this chapter found several variables that were associated with problematic mortgage costs that were not considered to be down to chance alone. These variables have been recast as binary variables, and are used as possible explanatory variables of the incidence of landlords reporting problematic mortgage costs and are shown in the Table 3.4 below.

Table 3.4: Potential influential factors on landlords reporting mortgage cost problems

Dependent variable	Explanatory variables	
Mortgage costs are a serious problem	Finding good tenant is serious problem HB administration is serious problem HB levels is serious problem Deposit disputes is serious problem Tenant damage is serious problem Tenant arrears is serious problem Tenant ABB is serious problem Repair costs is serious problem Reliable builders is serious problem Furnished tenancy Let in area selective licensing Let multiple occupation Letting main business Tenant on housing benefit Lone parent tenant	Property is located in the: • North east • North west • Yorkshire and Humberside • East Midlands • West Midlands • East • London • South east • South west One or more people in the tenant household • work full time • work part time • none work and one or more retired • none work and none retired Tenant required to provide reference Tenant supplied with written tenancy agreement A deposit is required from the tenant Tenant is on housing benefit Bought property from 2001 onwards

The statistical test considers each variable in turn to determine if it adds any additional value to explaining the most significant influences on the odds of landlords reporting problems with their mortgage costs and leaves only those that are not due to chance. If an individual variable does not add anything else to the explanation of why landlords report problems with mortgage costs then it is removed from the analysis. Only the significant results of the regression are shown and are set out below (Table 3.5).

Most of the possible explanatory variables were rejected in Model 1, which found that the odds of landlords reporting *serious problems with mortgage costs* were increased only by landlords who also had serious problems with tenant damage or if the landlords let property in the North East. Although the increased odds for these factors were statistically significant they were not very strong. Serious problems with tenant damage meant that the odds of landlords reporting serious problems with mortgage costs were increased only 0.184 times than landlords without serious problems with tenant damage. Letting property in the North East increased the odds of landlords reporting serious problems with mortgage costs only 0.227 times compared to those landlords who do not let property in the North East. Taken together these factors explain between 8 and 17 per cent of variance in the landlords' reports of serious problems with mortgage costs.

Table 3.5: Variables in the Model 1

	B	S.E.	Wald	df	Sig.	Exp(B)
Property in North East (1)	-1.484	.645	5.298	1	.021	.227
Tenant damage a serious problem(1)	-1.693	.508	11.117	1	.001	.184
Constant	.279	.653	.183	1	.669	1.322

Model Summary 1

-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
112.784a	.081	.168

The regression analysis was run again using a variable that combined landlord reports that their mortgage costs were a serious problem with those who reported their mortgage costs were a small problem, to provide an indicator that there was *any problem with mortgage costs*. This new variable was used as the dependent variable and produced a slightly different result and a stronger explanation of which factors increase landlords' reporting problems with their mortgage costs (Model 2). The new model explains between 16 and 24 per cent of variation in the rate at which landlords report problems with mortgage costs. The results of this regression are set out below in Table 3.6.

Landlords reporting serious problems with tenant damage and letting property in the North East remain and are therefore not considered to be down to chance, but their influence on problems with mortgage costs small, offering only weak explanations of landlord mortgage problems. However, the second model suggests that the strongest factors that influence the incidence of landlords reporting *any* problems with mortgage costs are households where no one works but one or more person are retired, which *decreases* the odds of landlords reporting problems with mortgage costs by 3.4 times; and letting in the South East and South West, which both decrease the odds of mortgage cost problems by 2.7 times. Serious problems with housing benefit administration, disputes about deposits, finding reliable workmen, letting in the North East and requiring tenant references increase the odds of landlords reporting problems with mortgage costs, but their influence is weaker.

Table 3.6: Variables in the Model 2

	B	S.E.	Wald	df	Sig.	Exp(B)
HB administration is a serious problem(1)	-1.018	.241	17.786	1	.000	.361
Tenant deposit disputes are a serious problem(1)	-1.525	.451	11.453	1	.001	.218
Tenant damage is a serious problem (1)	-.956	.315	9.244	1	.002	.384
Finding reliable builders is a serious problem (1)	-1.079	.511	4.460	1	.035	.340
Property is in the North East (1)	-.919	.439	4.376	1	.036	.399
Property is in the South East (1)	.994	.319	9.738	1	.002	2.703
Property is in the South West (1)	.989	.434	5.184	1	.023	2.688
No-one in tenant household works but at least one person is retired (1)	1.235	.480	6.630	1	.010	3.438
Tenant must provide a reference (1)	-.593	.261	5.156	1	.023	.553
Constant	.893	1.040	.737	1	.391	2.441
Model Summary 2						
-2 Log likelihood	Cox & Snell R Square			Nagelkerke R Square		
531.575b	.158			.243		

The second model therefore is helpful to identify circumstances that decrease the risk of mortgage cost problems, but finds only weak evidence that a series of factors increase the risk. These factors combine regional indicators which may be proxies for local housing market or economic conditions as well as business or policy risks, such as problems with housing benefit administration, tenant damage and finding reliable builders. These have a limited influence and it is likely that other factors associated with landlord mortgage problems may be important but unobserved in these data.

Conclusion

These EHS-PLS data provide a comprehensive overview of the characteristics of all landlords in the private rented sector during 2009-2010 and their approach and attitudes to letting and their perceptions of problems that arise. There are some strong bivariate associations between landlords reporting problematic mortgage costs and some types of lettings (furnished tenancies, multiple occupants, Northern regions, and in areas of selective licensing); repairs costs and finding builders; tenant behaviour (tenant damage, anti-social behaviour, disputing deposits and debts or arrears); and local housing benefit administration and the levels at which it is set. The regression analysis explains up to a quarter of the variance in landlord mortgage cost problems but suggests that many of these issues such as housing benefit administration, finding reliable builders, deposit disputes, tenant damage and property let in the North East of England, for example, exert only a weak influence over landlords' propensity to report problems with mortgage costs. These factors do reflect the same areas where rental income and void periods were identified as poor in Chapter 2. The analysis suggests that other factors also influence the incidence of landlords reporting problems with mortgage costs. The next chapter examines the lender loan book data that provides additional insight into the circumstances surrounding buy-to-let mortgage arrears.

4: Lender Loan Book Data Analysis

Summary

- Three per cent of buy-to-let loans in the lenders' data were one month or more in arrears in September 2013. At 1.4 per cent, the proportion of loans three months or more in arrears was slightly higher than the buy-to-let market average (1.16 per cent Q3-2013).
- Current valuation data was not available, but current property values, levels of equity and loan-to-values were derived by applying annual price changes from the Halifax House Price Index to the last valuation. These data represent estimations and not exact calculations.
- It is estimated that loan-to-values had increased across all regions since the loans were advanced but this was more pronounced in Scotland, Northern Ireland and northern regions of England. The incidence and magnitude of negative equity was also greater in these regions, especially Northern Ireland.
- The greatest proportion of loans (over two-fifths) was advanced between 2006 and 2008. Around five percent of these loans are in arrears and over a third of loans advanced during 2007 are estimated to be in negative equity.
- Just over half of borrowers had two or more loans and properties in Scotland and the North East were most likely to be purchased by landlords with multiple loans.
- The factors most likely to increase the odds of loan accounts being three months or more in arrears were: single borrowers, letting a flat, high current loan-to-values, having multiple loans, negative equity and taking out the loan during the period 2006 to 2008, letting property in the North East and in Northern Ireland.
- The influence of these factors on the incidence of buy-to-let mortgage arrears was shallow and overall only explained nine per cent of the observed variation between the loan accounts, again suggesting other factors are at play.

Introduction

This chapter turns attention to the lender loan book data which is a rich source of information about landlords' borrowing and the impact of external housing market risks on the loan. The chapter begins with an overview of what these data tells us about the landlords and their borrowing. This is followed by analysis that identifies the circumstances associated with actual mortgage arrears and again tests which factors are the strongest in influencing the odds of landlords being in arrears on their buy-to-let loan.

Overview of loans

This section provides an overview of the lenders buy-to-let loan book. It profiles the landlords' portfolios, properties purchased, size of the loans, loan-to-values, changes in borrowing and the equity held in the property.

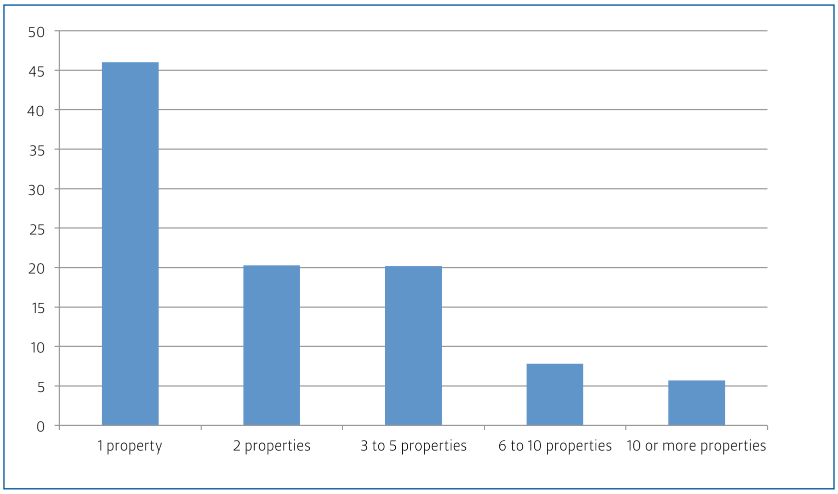
Landlord portfolios

Size of portfolio

The exact size of landlords' portfolios is uncertain, as the data can only provide the number of existing loans the landlord has with this individual lender. The largest proportion of loans is made to borrowers who have only one existing loan with this lender (46 per cent) (Figure 4.1). A total of 54 per cent of loans are made to borrowers with two or more loans. The largest number of existing loans made to the same person is 133 but only one per cent of loans are made to borrowers with 30 or more loans with this lender. Almost two-thirds of landlord borrowers who purchased property prior to the house price boom 2001 to 2005 (61 per cent) and at the market peak 2006 to 2008 (63 per cent) hold multiple loans, but only 42 per cent of borrowers who took out the loans since 2009 onwards.

The greatest proportions of loans are advanced to landlords with multiple loans in Scotland (61 per cent) and the North of England (63 per cent). The South East and South West have the lowest proportions of properties where borrowers have multiple loans (48 per cent and 47 per cent respectively). Landlords with multiple loans are slightly likely to let property at a distance from their home (57 per cent) compared to 43 per cent of landlords who do not have multiple loans.

Figure 4.1 Loans for buy to let properties per customer (%) (n=338,908)



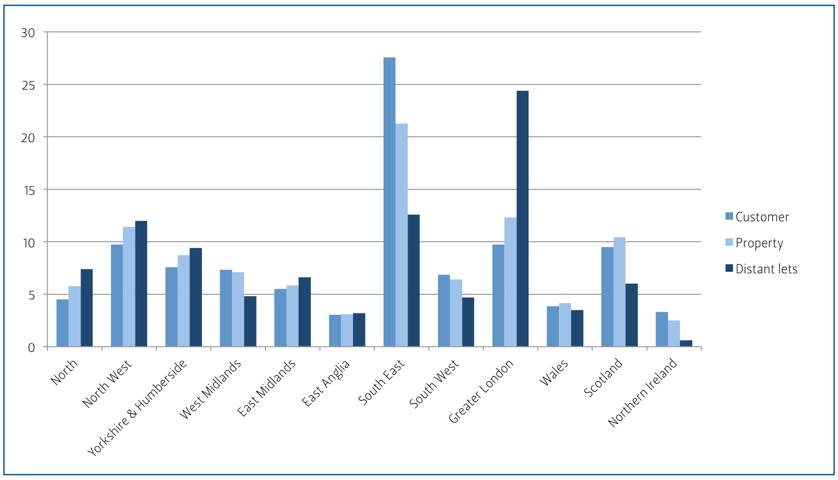
Source: Loan book data

Location of properties

Figure 4.2 illustrates the locations of the properties for which loans have been advanced, the location of the landlord borrowers and of property let in regions different from the landlord borrowers' home region.

By far the greatest proportion of loans is advanced to landlord borrowers who live in the South East of England (28 per cent), followed by London, the North West and Scotland (10 per cent each) (Table 4.2). Similarly, the location of properties for which the loans were advanced follows a similar pattern, with 21 per cent of purchases made in the South East. The area where the greatest proportion of landlord borrowers has used loans to purchase property locally is Northern Ireland (94 per cent) and the lowest is Greater London (56 per cent). A total of 78 per cent of landlord borrowers received loans to purchase property in the same region in which they lived, and 22 per cent used the loans to buy property outside of their home region. The regions with the greatest proportion of properties let by landlords from a different region were London followed by the South East and the North West.

Figure 4.2: Location of landlord customers, total properties and properties let at a distance by region (n=334,493) (%)



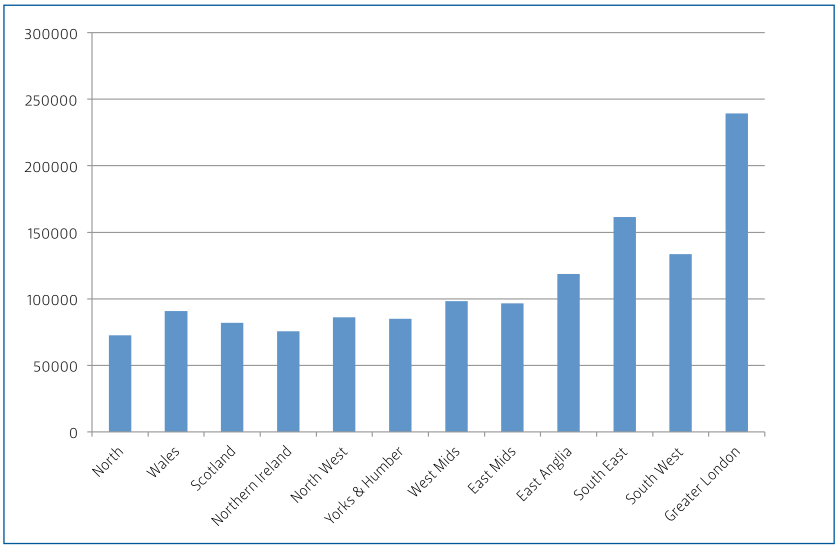
Source: Loan book data

Value of portfolio

Current valuations of the properties subject to the loans were not available. However, the current value of the property can be estimated by applying the changes reflected in the Halifax House Price Index to the last valuation made of the property. This provides an estimated current value as at September 2013. The mean estimated current value of property to which loans are attached was £145,791 and the median value was £113,995. The estimated current values of the properties vary by region (Figure4.3). As anticipated, values decline further away from London. The median value of stock is below £100,000 in all regions except London, the South East, South West and East Anglia.

The estimated current value of property bought by landlords with multiple loans (mean £133,408 and median £104, 042) was lower than landlords who had single loans (mean £161,250 and median £127,219).

Figure 4.3: Estimated current median value of property by region (£) (n=311,565)

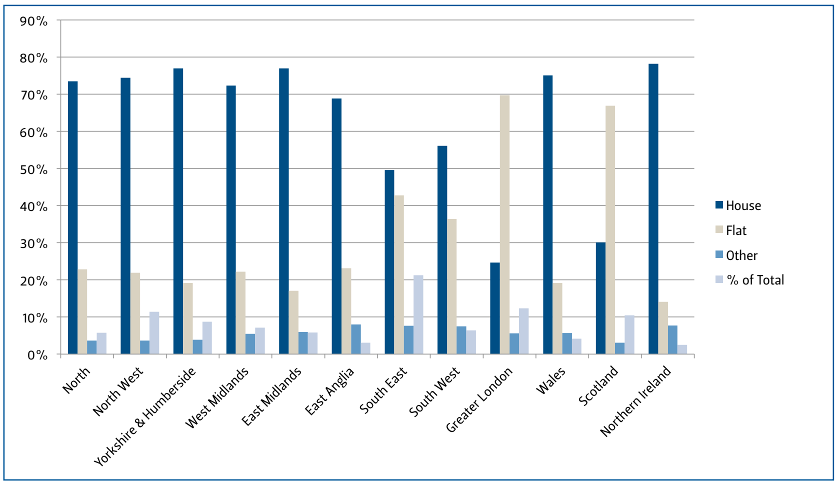


Source: Loan book data

Property purchased

The majority of buy-to-let loans have been used to purchase a house (57 per cent) compared to 38 per cent used to purchase a flat or maisonette and five per cent used to purchase another form of property, including bungalows. The greatest proportions of loans made for flat purchases were made in Greater London (70 per cent) and Scotland (67 per cent) (Table 4.4). Loans are more frequently used to purchase houses in the northern regions, Northern Ireland and Wales – possibly reflecting lower costs- and flats in the southern regions and Scotland –reflecting higher costs and the composition of the local dwelling stock.

Figure 4.4: Proportion of loans made in each region by property type (%) (n=338,908)

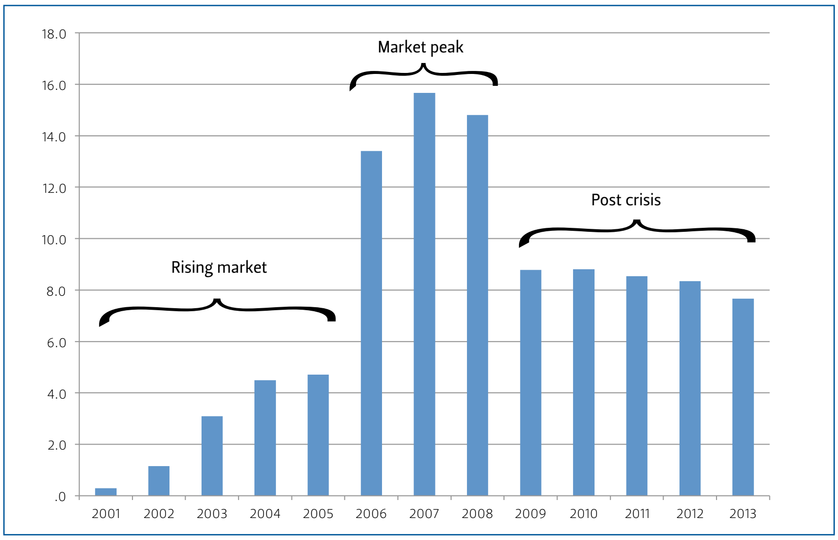


Source: Loan book data

Year loans advanced

Figure 4.5 illustrates the year the original buy-to-let loans were made. These data suggest three distinct periods of buy-to-let lending. The number of buy-to-let loans made in the first years of the last decade rose steadily, rose rapidly at the peak of the housing market boom between 2006 and 2008 and then following the financial crisis that hit from 2009 onwards, the number of loans fell sharply. The proportion of loans made since 2009 has remained higher than during the years leading up to the boom.

Figure 4.5: Year original loans made to landlord customers (%) (n=338,908)



Source: Loan book data

Loan-to-values

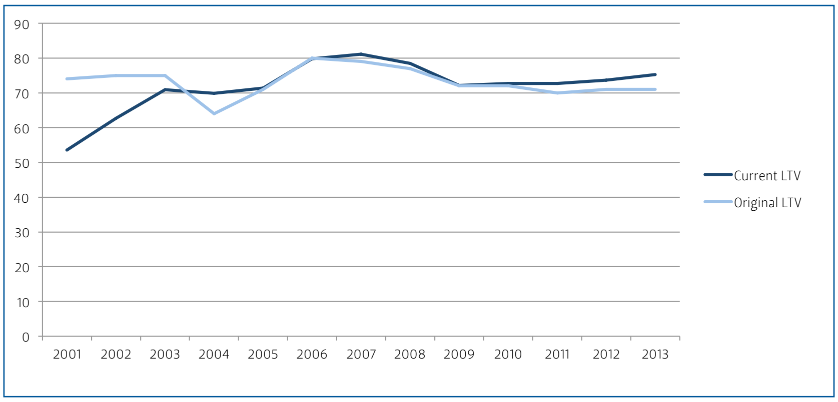
Most buy-to-let loans are made on an interest only basis and the capital is not repaid. If the market remained constant and unless large sums are overpaid the sums owed do not reduce and loan-to-values stay the same. If the market rises or falls and payments remain constant then the loan-to-values reduce or increase respectively. As described, current property values were estimated using the Halifax House Price Index, allowing current loan-to-values to be estimated by comparing the estimated current value of the property with the outstanding balance on the account.

Figure 4.6 illustrates the average original loan-to-values and the estimated average current loan-to-values by the year the loan was advanced. The loan book shows variation in the loan-to-values due to a combination of different lending criteria throughout the market cycle, and also because of the impact of house price volatility. Loans made during the period 2001 to 2003 were made at 75 per cent but saw rising house prices reduce the loan-to-values substantially. It appears that there was some tightening of loan-to-value lending criteria prior to the market peak, as original loan-to-values reduced to 65 per cent, following which average loan-to-values rose again to 80 per cent at the peak of the market, before reducing after the crisis to around 70 per cent. Current loan-to-values for loans made during 2004/5 and since 2010 are higher than the original loan-to-values, no doubt due to falling house prices in some locations.

Across all loans, the greatest proportion of loans advanced on high loan-to-values, over 86 per cent were made on properties in the South East (16 per cent). However, the highest proportion of loans with high original loan-to-values within regions was made in the North (17 per cent), Scotland and Yorkshire (both 14 per cent).

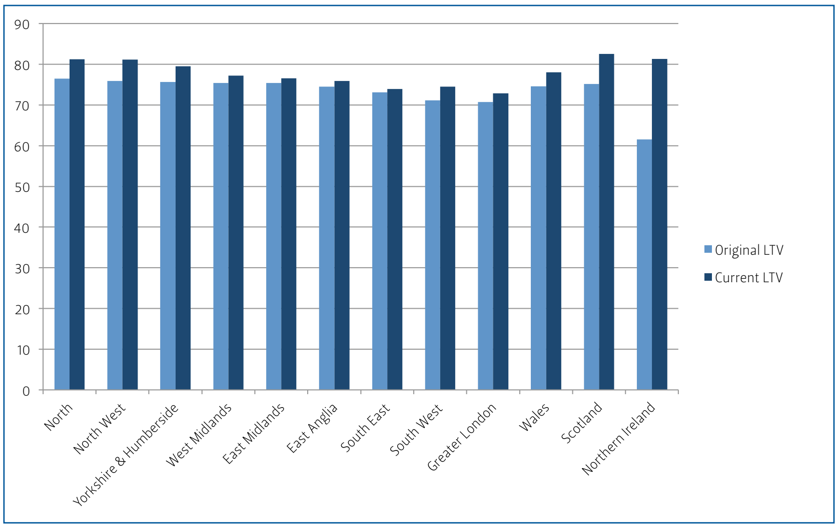
Loans in London have the lowest estimated current loan-to-values and Scotland, Northern Ireland, the North East and North West the highest (Figure 4.7). Across all loans, the estimated current loan-to-values are higher than for when the loans were originally made, but have increased sharply in Scotland and Northern Ireland. The median current estimated loan-to-value is 77 per cent, although the mean average is slightly below this at 73 per cent. The highest proportion of loans has current loan-to-values of between 76 and 85 per cent (21 per cent) (Figure 4.8). A total of 48 per cent of loans have current loan-to-values in excess of 75 per cent. As few current buy-to-let products would permit such high loan-to-values, this suggests that almost half of landlord borrowers would be unable to remortgage.

Figure 4.6: Estimated current median loan-to-value by year original loan made. (%) (n=311,532)



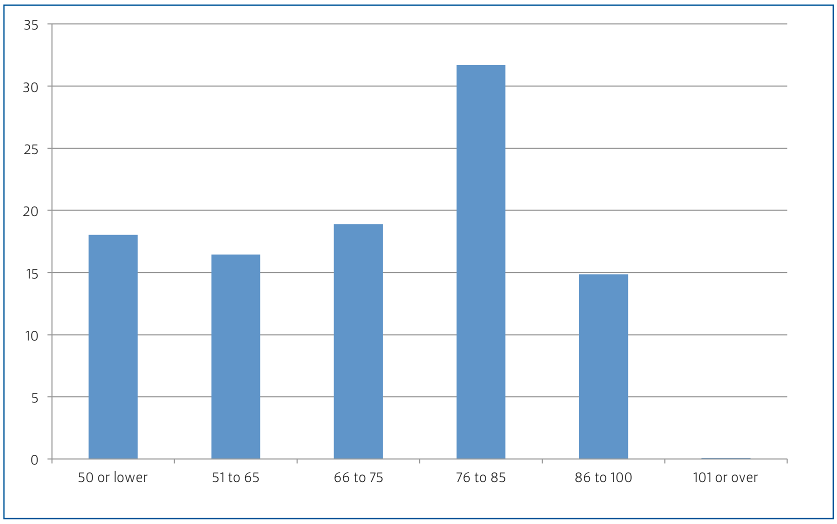
Source: Loan book data

Figure 4.7: Mean estimated current and original loan-to-values by region of property (%) (n=311,542)



Source: Loan book data

Figure 4.8: Estimated current loan-to-values of all loans (%) (n=338,032).



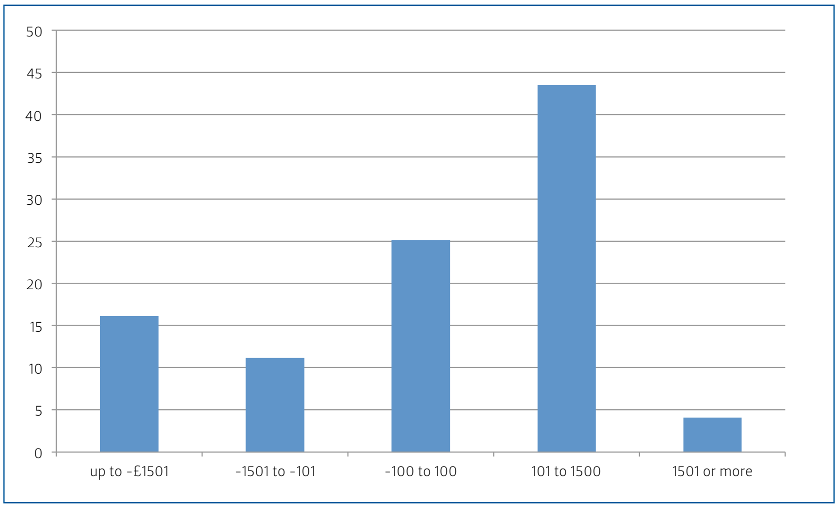
Source: Loan book data

Changes in borrowing

As the majority of loans are granted on an interest only basis (82 per cent) it is expected that the basic capital outstanding will not change, with the slight variation from the original sum possibly accounted for by slight over- and under-payments over time. This means that the loan-to-values are affected most substantially by changes in house prices as seen above. Landlords can, however, reduce their loan-to-values by overpaying their mortgages, which can also provide a 'buffer' against missed mortgage payments.

Figure 4.9 shows the proportion of loans that show increased or decreased borrowing since the original loan was advanced. A total of 16 per cent have overpaid the loan by more than £1500, 11 per cent by between £101 and £1500. The majority of accounts show either no significant change (25 per cent) or have increased their borrowing by £100 or more (48 per cent). Nonetheless, a quarter of landlords have overpaid their mortgage by some amount, albeit small, with the potential to limit arrears.

Figure 4.9: Change in outstanding balance from original advance (£/%). (n= 338,908)



Source: Loan book data

The regions with the greatest proportion of landlords who overpaid their mortgage by £1500 or more were the West Midlands and Northern Ireland (20 per cent) and the lowest was East Anglia and the South West (13 per cent).

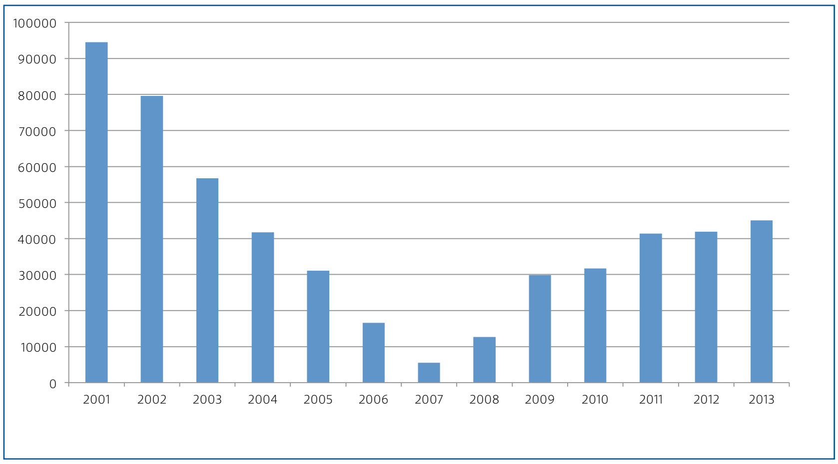
Housing equity

As discussed in Chapter 2, negative equity is not necessarily a problem unless an owner wishes to or has to sell, and evidence in respect of negative equity and its role in the formation of mortgage arrears is limited. However, an estimate of whether any equity is held within the property provides an indicator of how easily a landlord can exit their investment if the finances of an individual property no longer provide an effective return. Landlords may sell their property in negative equity, usually with the permission of the lender, but will incur a shortfall debt - the difference between the debts owed to the lender and the value obtained for the property - which can act as a disincentive to sell.

Estimates of negative equity are notoriously difficult to determine as they are sensitive to the assumptions made and the data used in the calculations (Tatch, 2009). In this instance, an estimate of the equity held in the property can be made by using the estimated current value and deducting the outstanding balance on the loan. Figure 4.10 illustrates the estimated median amounts of equity held in properties for which the loans were advanced by the year the original loan was made. As anticipated the properties with the least equity were purchased near the peak of the housing market cycle 2006 to 2008 and the greatest sums of equity are held in properties bought when the market was rising in the early years of the last decade. Again as expected, there are regional differences with properties in Greater London and the South East holding the most and the North, Scotland and Northern Ireland the least (Figure 4.11).

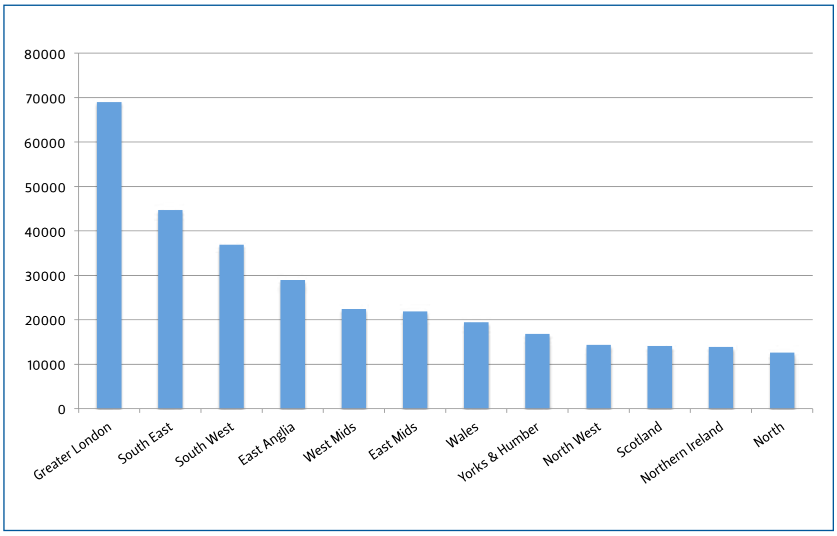
A total of 11 per cent of loans (34,341) were estimated to be in negative equity (in September 2013) and as such were secured on properties where the value of the property was likely to be insufficient to repay the loan. The majority of loans estimated to be in negative equity were those made at the peak of the housing market 2006 to 2008 (Figure 4.12), with 34 per cent of all loans made in 2007 likely to be in negative equity. The regions with the highest incidence of loans held on properties likely to be in negative equity were Northern Ireland, Scotland and the North West (Figure 4.13). Northern Ireland had the greatest proportion of loans made in that location estimated to be in negative equity, the region represented only 2.5 per cent of all loans but 5.9 per cent of all loans estimated to be in negative equity. The region with the lowest proportion of loans likely to be in negative equity was the South East (0.7 per cent).

Figure 4.10: Estimated median equity by year loans made. (n=311,805)



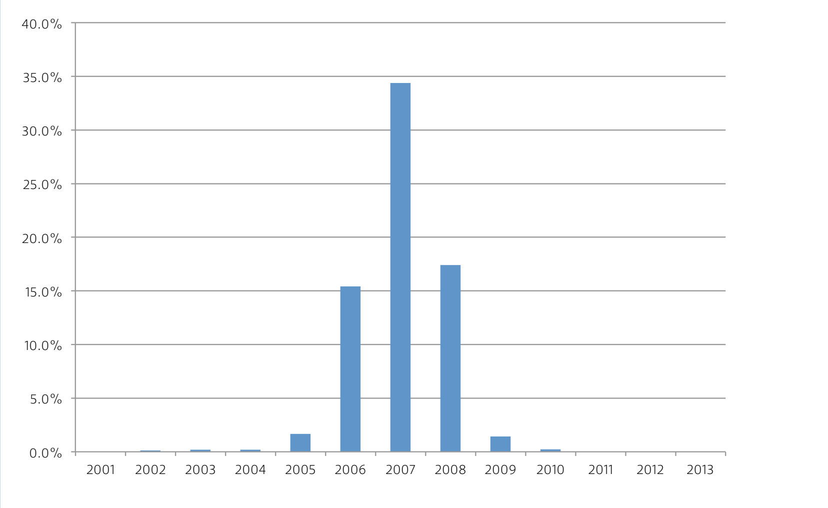
Source: Loan book data

Figure 4.11: Estimated median equity by region of property. (n=311,805)



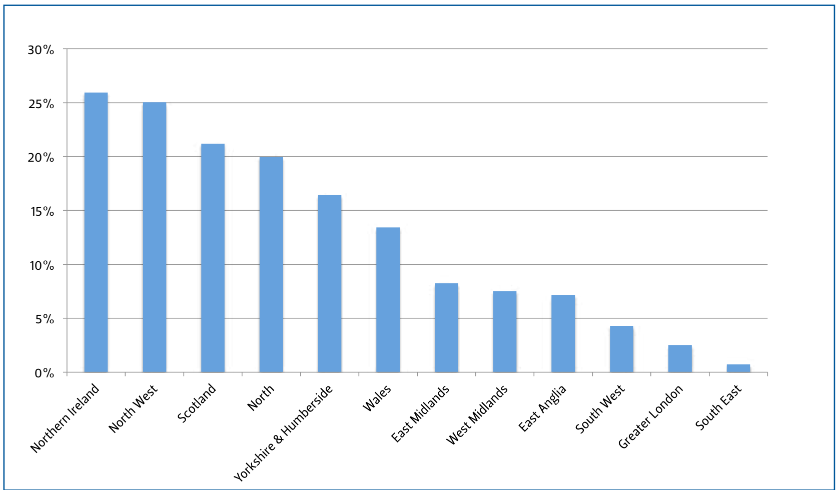
Source: Loan book data

Figure 4.12: Negative equity by year original loan made (%) (n=34,341)



Source: Loan book data

Figure 4.13: Loans secured on property in negative equity by region (%) (n=34,341).

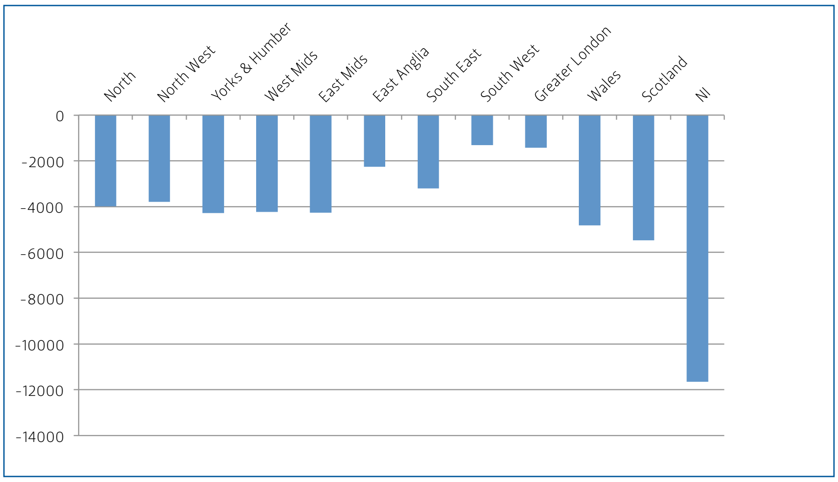


Source: Loan book data

The median estimated value of negative equity held on the accounts is greatest in Northern Ireland and lowest in the South West and Greater London (Figure 4.14). Estimated negative equity in Northern Ireland has the greatest value as well as the highest incidence. Very few accounts have estimates of negative equity in excess of £50,000, although the maximum is almost £290,000. The mean average estimated sum of negative equity is £5,772 (Figure 4.15).

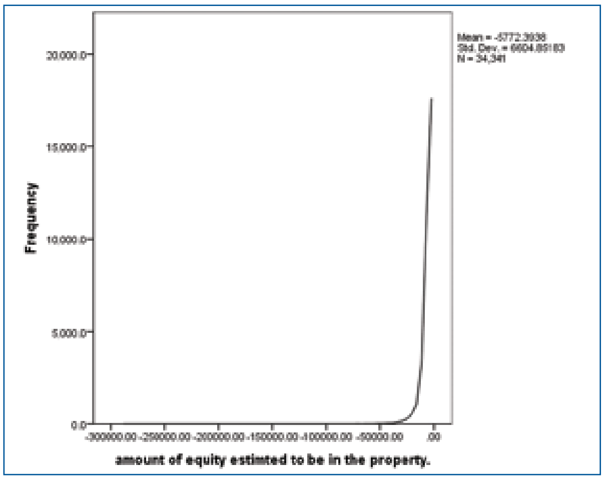
Of all loans the same proportions of flats and houses are in negative equity 11.8 per cent and 11.3 per cent respectively, but within each region a greater proportion of flats are in negative equity than houses (Figure 4.16). The regions with the greatest proportions of flats in negative equity are Northern Ireland, the North West and Yorkshire and Humberside.

Figure 4.14: Estimated value of negative equity by region of property (£) (n=34,341)



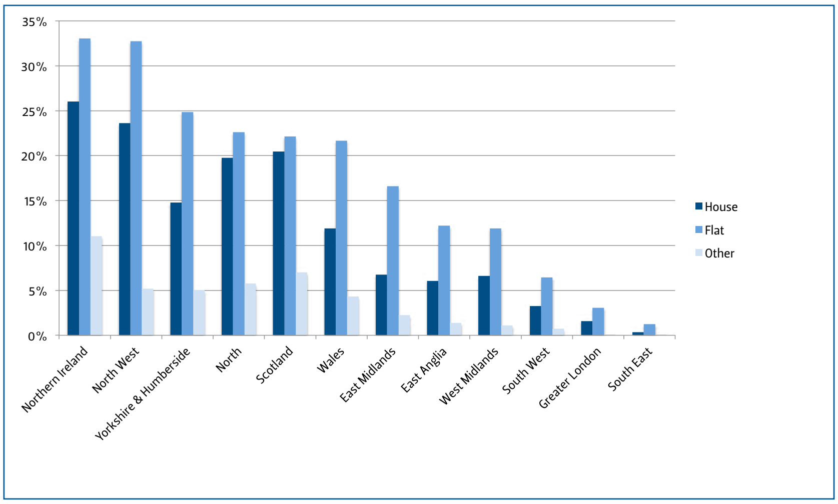
Source: Loan book data

Figure 4.15: Values of all loans in negative equity (£) (n=34,341)



Source: Loan book data

Figure 4.16: Negative equity by property type and region



Source: Loan book data

The loan book data does not include the anticipated rental cover, interest rates charged or details about the borrower, such as their income and/or their credit score, to enable an assessment of the lending criteria and affordability; but these data have facilitated an analysis of the characteristics of the loans and the impact on them of external market shifts. The analysis shows that a sizeable minority of borrowers now have loans with high loan-to-values, negative equity, cannot remortgage or would incur shortfall debts if they sold the property, all of which may represent stresses on landlords' managing their property investments.

Arrears and possessions

A total of 10,497 loan accounts had arrears of one month or more (3.1 per cent) and 1.4 per cent of loans were three months or more payments in arrears. This compares to a slightly lower industry average of buy-to-let loans three months or more in arrears, which was 1.19 per cent at Q2-2013 and 1.16 per cent at Q3-2013 (including properties in arrears but under the receiver of rent's control) (CML Table AP5). A total of 356 accounts (0.1 per cent) are held in possession, but as this is cross-sectional data the rate of possession for the book is unknown.

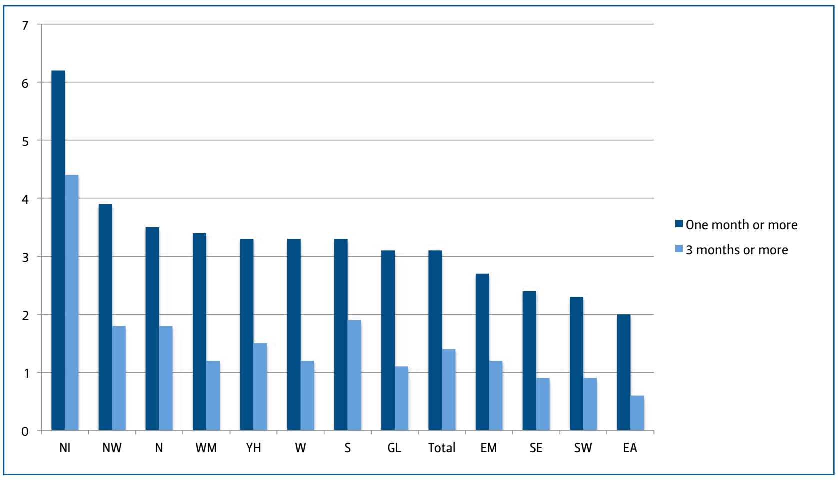
There were approximately 4.7 million private rented homes in 2011 (CLG Live table 101), and if 40 per cent of these were mortgaged (Chapter 3) and three per cent are in any arrears, as this loan book data indicates, it would mean an *estimated* 56,400 tenanted homes have landlords struggling with their mortgage. This could be a conservative estimate as interviews revealed landlords struggling but avoiding mortgage debt (see Chapter 5), although the loan book data had slightly above average rates of accounts three months or more in arrears which may moderate any over-estimation. Nonetheless, these data suggest a sizeable proportion of privately rented homes are let by landlords currently struggling with their loan repayments.

The previous analysis illustrated the market risks that may have weakened the basis on which some loans were advanced or taken out. This section explores the relationship between these factors and the incidence of accounts in arrears or possession.

Property region

Across the whole loan book, the greatest proportion of all loan accounts one month or more in arrears are held against properties in the South East (16.5 per cent of all accounts in arrears). However, as over a fifth of all buy-to-let loans are for properties in the South East, arrears in the South east are disproportionately low (2.4 per cent of all accounts within that region). The region with the greatest proportion of loan accounts in arrears is Northern Ireland, where 6.2 per cent of all loan accounts have missed at least one payment (Table 4.17). Other regions with above average rates of accounts in arrears are the North West (3.9 per cent of accounts in this region are in arrears), which accounts for 11.4 per cent of all loans, but 14 per cent of all loans in arrears, and the North (3.5 per cent), which accounts for 5.8 per cent of all loans but 6.4 per cent of all loans in arrears. Northern Ireland, Scotland, the North West and North of England also have the highest rates of loan accounts in arrears by three months or more.

Figure 4.17 Proportion of accounts in arrears by region (n=338,063)



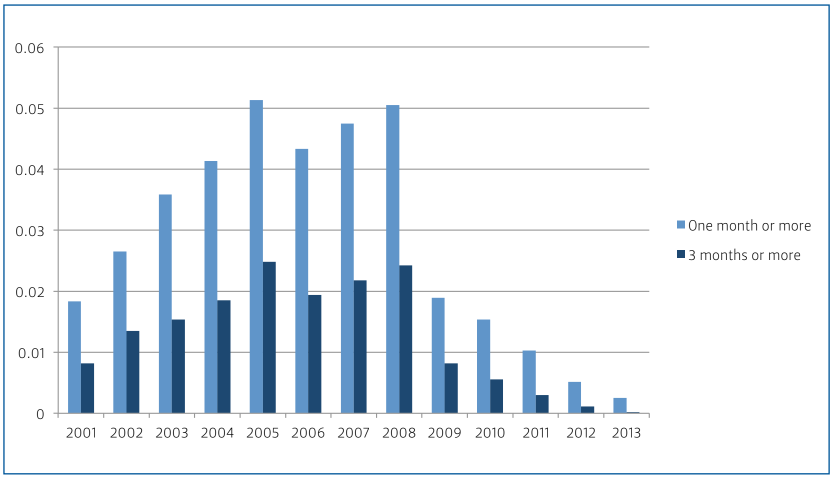
Source: Loan book data

A total of 356 loan accounts are showing as in possession. Once the property is sold then the lender no longer holds the records of the account on the main system. The largest portion of all loans where the property is held in possession are those where the property is in the North West of England representing 26 per cent of all properties held possession, followed by Northern Ireland (14.5 per cent), the North and Yorkshire and Humberside (both 11.5 per cent). The corresponding higher rates of arrears in these areas suggest that it is plausible that more possessions also occur in these regions, however, these results may reflect the time to sell properties in these areas so they may be held in possession for longer, rather than reflecting a greater incidence of possessions.

Year of Purchase

Loans made in 2005 and 2008 have the greatest proportions of loans in arrears (Figure 4.18). Figure 4.6 illustrated a short period of lower original loan-to-values for loans advanced during 2005/6 which may explain the dip in the incidence of arrears on loans in 2006. Arrears on loans made since the financial crisis on tighter lending criteria have substantially fewer cases of arrears.

Figure 4.18: Proportion of loans in arrears by year loan advanced (%) (n=338,063).

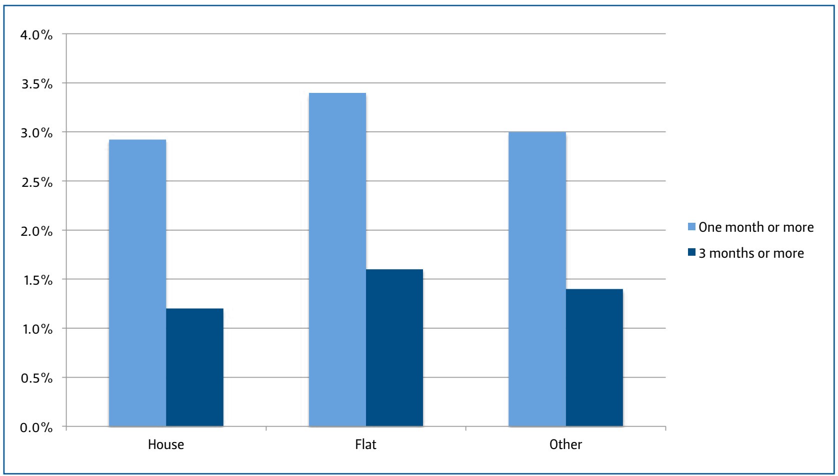


Source: Loan book data

Property types

A greater proportion of loans used to purchase flats are in arrears compared to loans secured against houses (Figure 4.19).

Figure 4.19: Proportion of loans in arrears by property type (%) (n=338,063)



Source: Loan book data

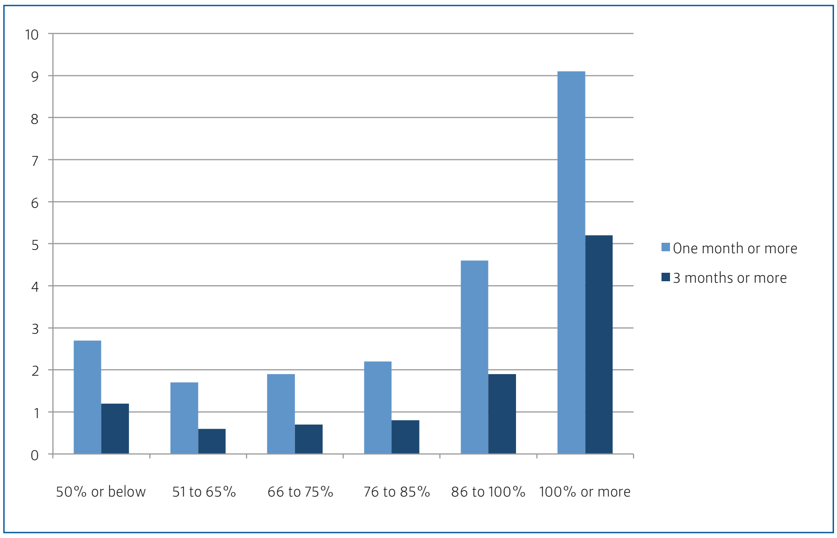
Flats bought during the periods 2001 to 2005 and 2006 to 2008 show little difference in the incidence of arrears on the loans (4.6 per cent and 4.7 per cent respectively), but the incidence of arrears on flats bought during 2009 to 2013 is much lower at 0.9 per cent.

Loan-to-values

There are significant but largely extremely weak associations between the number of months arrears on the account and the current loan-to-value, the amount of equity held in the property, the current value and the year the original loan was made (Pearson Correlation is 0.059, -0.031, and 0.06, 0.46 respectively, where the strongest associations are those with Pearson values near 1). There is no correlation between the size of the original advance, the original loan-to-value and the months the account is in arrears.

However, although a linear relationship may not be apparent, whereby the amount of arrears increases with the size of the loan-to-value, higher loan-to-values are associated with having at least one month arrears on the account (Figure 4.20). Loans where the estimated current loan-to-values is 86 per cent or more represent 30 per cent of all loans but 55 per cent of all accounts in arrears. A total of 59 per cent of loans in possession have current loan-to-values in excess of 100 per cent. Two-thirds of loans in possession comprise loans originally advanced on the basis of a loan-to-value in excess of 76 per cent. Originally only 10 per cent of loans were made on loan-to-values of between 86 and 100 per cent, and these loans are 21 per cent of all accounts in arrears.

Figure 4.20: Current loan-to-values by arrears (%) (n=311,534)



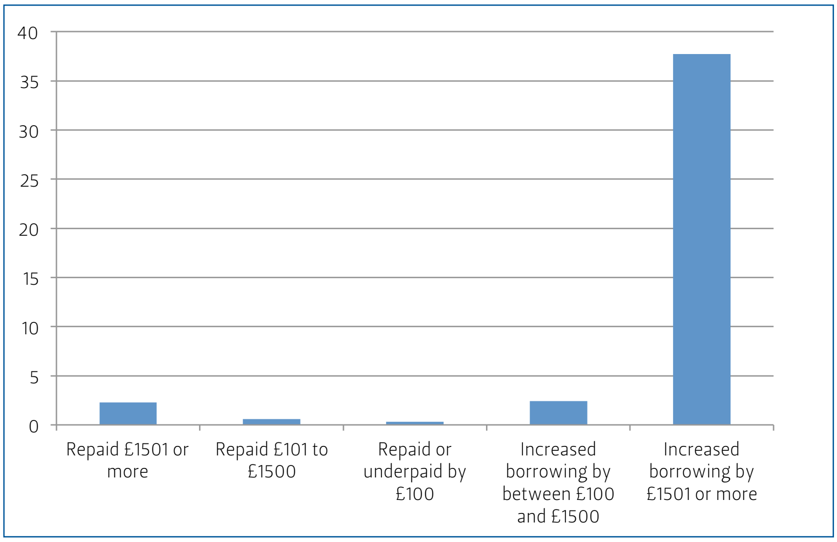
Source: Loan book data

Repayment loans routinely reduce mortgage debt and comprise 13 per cent of all loans and have a lower proportion of accounts in one month or more in arrears (2.5 per cent) compared to interest only loans (3.2 per cent).

Under- and overpayments to account

As mentioned earlier overpayments, to the loan account hold the potential to act as a 'buffer' and limit arrears on the account and this does appear to be the case. A much smaller proportion of loans with overpayments above £1500 are carrying arrears compared to accounts where the borrowing has increased by more than £1500 (Figure 4.21).

Figure 4.21: Proportion of accounts with under/overpayments in arrears (%) (n=338,063).



Source: Loan book data

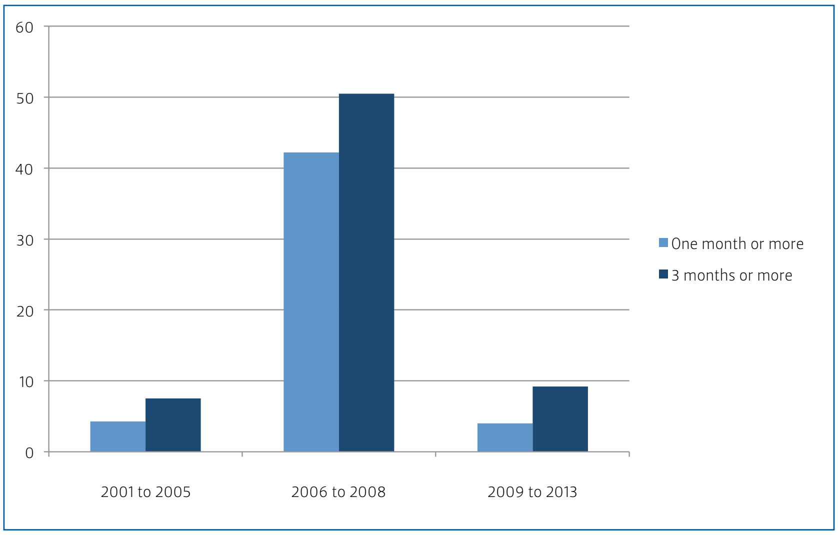
A total of 19 per cent of loans have been remortgaged, indicated by the latest valuation date being different from the year the original advance was made, and ten percent of all loans have been remortgaged and the borrowing has also increased by more than £100. A slightly greater proportion of loans subject to remortgaging are in arrears (3.4 per cent) compared to loans that have not (2.9 per cent).

Negative equity

There is a clear association between estimates of negative equity and arrears signalling the potential for losses and shortfall debts for lenders and borrowers. Nine per cent of loans estimated to be in negative equity are in arrears compared to 2.6 per cent of loans that are not estimated to be in negative equity. Negative equity is likely to be present on 11 per cent of loans but 30 per cent of accounts one month or more in arrears, 38 per cent of accounts in three months or more arrears, and 61 per cent of accounts in possession are secured against properties estimated to be in negative equity.

Almost one per cent of all loans are both one month or more in arrears and estimated to be in negative equity, and 95 per cent of these were advanced between 2006 and 2008. Over two fifths of loans one month or more in arrears and half of loans three months or more in arrears advanced during the peak market years 2006 to 2008 are also estimated to carry negative equity (Figure 4.22).

Figure 4.22: Proportion of accounts in arrears also in negative equity by year loan advanced (%) (n= 1462)



Source: Loan book data

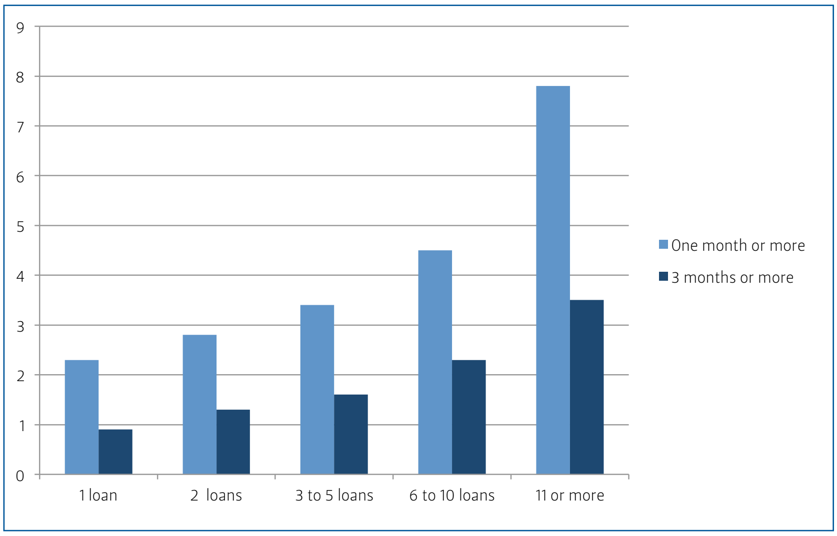
The relationship between negative equity and arrears remains uncertain as the interviews found no widespread evidence of strategic default among landlords as they were committed to their loans and also wished to avoid incurring shortfall debts. The association between arrears and negative equity here could mean that both variables are measures of another event or phenomena in the market associated with a weaker economy, rental and/or housing markets.

Applicants

Although the EHS-PLS data did not demonstrate an association between problematic mortgage costs and landlords with multiple properties the loan book data is clear. The proportion of accounts in arrears is greater the more loans a landlord holds (Figure 4.23). Landlord borrowers with multiple loans make up 54 per cent of all loans, but 66 per cent of loans with any arrears and 71 per cent of accounts three months or more in arrears and accounts in possession. Since the financial crisis many lenders have restricted lending to landlords with multiple loans and/or properties, placing a cap on the number of loans or properties held to 3, 5 or 10 (see next chapter).

Single borrowers are more likely to hold loan accounts in arrears than joint borrowers, as single borrowers make up 55 per cent of all loans but 74 per cent of all loan accounts in arrears and 76 per cent of accounts in possession. However, it is uncertain from these data whether loans have been advanced to two single borrowers in the same household, and thus in practice comprise loans and properties within the same overall portfolio. By placing property in the name of spouses landlords may split tax relief and/or overcome the maximum ceiling on investments within one lender, so some holdings and portfolios may be, in a proportion of cases at least, larger than these data suggest. Single applicants could also reflect lower levels of household financial resources available to landlords to overcome income shocks to their property or portfolio's finances.

Figure 4.23: Arrears by number of loans held by borrowers (%) (n=338,063)



Source: Loan book data

Loans made to purchase property away from the region where the landlords' reside have a slightly greater proportion of loans in arrears (3.6 per cent) compared to all loans (3.1 per cent). Loans made on property at a distance from the landlords' home account for 22 per cent of all loans but 26 per cent of all loans in arrears.

This section has demonstrated that higher levels of buy-to-let mortgage arrears are associated with a range of factors that include flats, high loan-to-values, negative equity, Northern Ireland and northern regions of England, single applicants, and landlord borrowers with multiple loans. The following section tests for which factors exert the most influence on the odds of loan accounts being in arrears.

Which factors increase the odds of arrears on loan accounts?

As in the previous chapter this analysis uses binary regression to identify which factors increase the odds of loan accounts falling into arrears, and loan accounts falling into serious arrears of three months or more missed payments. First binary dummy variables are made for the potential explanatory variables (Table 4.1).

Bivariate analysis indicated strong associations between these variables and the incidence of arrears or possession, but using these as explanatory variables in a binary regression produced extremely weak explanatory models for the factors that increase the odds of arrears and possession occurring on buy-to-let loans suggesting other factors are at play.

Table 4.1: Potential factors that influence the incidence of arrears or possession

Dependent variables	Explanatory variables	
Any arrears on account (one month or more) Three months or more arrears on account	Multiple loans Single borrower Property a flat Buying 2006 to 2008 Negative equity present High original loan to value (86 per cent or more) High current loan to value (86 per cent or more) Property in the North Property in the North West Property in Yorkshire and Humberside Property in the West Midlands	Property in the East Midlands Property in East Anglia Property in the South East Property in the South West Property in Greater London Property in Scotland Property in Wales Property in Northern Ireland Property in other regions to customer

The first model presented in Table 4.2 finds that interest only loans for rented properties in East Anglia and Scotland reduce the odds of loan accounts being in arrears. The odds of loan accounts carrying any arrears are increased if the properties are in London by 0.9 times, 0.8 times if the loan was made between 2006 and 2008 and if the landlord has multiple loans (0.7 times the odds). However, this model only explains between two and seven per cent of the variation in the incidence of arrears on loan accounts.

Table 4.2: Model 1 One month or more arrears on the loan account

Variables in the Equation						
	B	S.E.	Wald	df	Sig.	Exp(B)
Single borrower (1)	-.801	.023	1218.938	1	.000	.449
Interest only (1)	.249	.029	74.048	1	.000	1.283
High current LTV(1)	-.598	.030	403.283	1	.000	.550
Multiple loans(1)	-.312	.022	208.252	1	.000	.732
Loan 2006 to 2008 (1)	-.248	.028	79.625	1	.000	.781
Negative equity (1)	-.735	.029	664.158	1	.000	.480
West Midlands (1)	-.201	.038	27.671	1	.000	.818
East Anglia (1)	.305	.072	17.782	1	.000	1.356
London(1)	-.109	.032	11.531	1	.001	.896
Scotland (1)	.140	.033	18.005	1	.000	1.151
Northern Ireland (1)	-.635	.049	170.172	1	.000	.530
Constant	-1.486	.115	166.610	1	.000	.226
Model 1 Summary						
-2 Log likelihood	Cox & Snell R Square		Nagelkerke R Square			
85077.905b	.018		.071			

The second model (Table 4.3) suggests that the strongest factors that influence the odds of three months or more arrears on loan accounts are the property being in the South East or East Anglia, which reduces the odds of arrears on the loan account by 1.1 and 2.0 times respectively, and having a repayment loan which reduces the odds of arrears by 1.2 times. London has disappeared as a factor that increased arrears and here the strongest factors that increase the odds of three months or more arrears are the property located in the North, which increase the odds by 0.89 times, having bought in the period 2006 to 2008 (0.86) and the property being a flat (0.84) but these remain weak. A high original loan-to-value and letting property in another region decreases the odds, possibly as they are also associated with letting in the South East. This model only explains between 1 and 9 per cent of the variation in the incidence of arrears on accounts.

Table 4.3: Model 2 Three months or more arrears on the loan account

Variables in the Equation						
	B	S.E.	Wald	df	Sig.	Exp(B)
Property in other region(1)	.086	.035	6.127	1	.013	1.090
Single borrower (1)	-.836	.034	591.730	1	.000	.434
Interest only (1)	.215	.045	22.987	1	.000	1.240
Flat (1)	-.171	.031	30.535	1	.000	.843
High current LTV(1)	-.685	.047	216.071	1	.000	.504
Multiple loans (1)	-.479	.033	208.718	1	.000	.619
Loan 2006 to 2008 (1)	-.151	.043	12.505	1	.000	.860
Negative equity (1)	-1.015	.041	599.878	1	.000	.362
High original LTV (1)	.169	.041	16.543	1	.000	1.184
Property in North (1)	-.124	.057	4.685	1	.030	.883
Property in East Anglia (1)	.691	.133	26.876	1	.000	1.995
Property in Northern Ireland(1)	-1.071	.060	315.988	1	.000	.343
Constant	-2.131	.165	167.593	1	.000	.119

Model 2 Summary		
-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
44241.789b	.012	.087

These models are a poor fit and it is likely that there are unobserved intervening variables that would provide a greater explanation of the relationship between loan accounts in arrears and the other variables.

Conclusion

The analysis of the lender loan book data reveals a number of significant associations between the incidence of arrears or possessions on the loan accounts and lending to borrowers with multiple loans, high current loan-to-values, negative equity, loans to purchase flats or property in the North of England, or loans made between 2006 and 2008. The statistical analysis retains many of these factors to explain arrears and possessions on buy-to-let loans but finds only a weak influence of the odds of arrears occurring on accounts, and overall the model explains little variance of arrears between accounts. This model is weaker than that produced from the EHS-PLS data that suggests the inclusion of landlord and tenant attributes increases the explanation of the factors that increase the odds of arrears and possessions. The qualitative in-depth interviews in the next chapter provides further explanation of the factors that influence landlords' buy-to-let mortgage arrears and relate to the changing market context in which they are operating and landlords' and lenders' business practices and approaches to lending.

5: Landlords and lenders' experiences of buy-to-let mortgage arrears

Summary

- Lenders and regulators conceive buy-to-let as a business but it is not always operated as such.
- The interviews suggest that sitting behind the formal arrears figures there were a pool of landlords who avoided arrears only by subsidising their rental property or portfolios from their personal income.
- Market and policy risks become more apparent in weaker housing markets where landlords must demonstrate more proficient business skills to sustain their property or portfolio. Stronger markets are more forgiving to landlords who have, or had, less business orientated approaches to their letting activities.
- Across all markets adverse events in landlords' *personal* and/or other business financial lives also contribute to the incidence of buy-to-let mortgage arrears. These issues may reflect some of the missing factors that the quantitative analysis was unable to identify.
- Lenders were also complicit in supporting poor investments, notably at the height of the market prior to the financial crisis. Lenders with more prudent approaches to underwriting in the buy-to-let market have fewer arrears.
- Some professional landlords effectively let properties to tenants in receipt of housing benefit, but this sector demands a different skill set and more intensive management.
- Problems with tenants not passing on housing benefit or claiming correctly had contributed to some landlords' mortgage arrears but did so in the context of difficult markets and/or limited experience.
- Landlords interviewed were, often reluctantly, remaining in the housing benefit sector, but there were suggestions that some landlords had shifted their letting strategies by avoiding young single person lets and/or larger family size homes.

Introduction

This chapter reports on the qualitative in-depth interviews with landlords, lenders and landlord representatives and illuminates some of the practices apparent in the market that sit behind the indicators identified in the previous analysis.

As mentioned, Crook *et al*. (2012) organised the risks to landlords' letting practices as business risks, those that arise from practices within the control of landlords; and from market risks, or external events that exert a negative influence over the business operation. Existing evidence also indicated that the regulatory or policy environment in which landlords operate represented a risk and had the potential to disrupt their letting activities. The most significant of these policy factors relates to housing benefit changes. However, the in-depth interviews also revealed that a fourth category, landlords' own *personal* financial situation also affects letting outcomes, as rental income may be diverted from paying the buy-to-let mortgages to other things.

There is a recursive relationship between these four arenas, as astute business decisions at the outset of the purchase and during the holding of the buy-to-let property may mitigate market risks, and personal financial circumstances and policy may also respond to market signals. Before a short note about the incidence of mortgage arrears in the market, the remaining chapter draws upon the in-depth interview evidence from landlords, their representatives and lenders and reflects on the operation of the buy-to-let *business*, external *market* changes, landlords' *personal* financial circumstances and the changing *policy* environment's impacts upon the incidence of buy-to-let mortgage arrears.

Although lenders and regulators conceive buy-to-let to be a business proposition and anticipate that it is self-supporting, it is clear that a portion of landlords do not conceptualise or operate their letting activities this way, or did not do so at the outset. In areas where housing and rental markets have not held up during the market downturn, poor business decisions are exposed by adverse market conditions, which limit landlords' ability to exit their investment. Effective business practice can and does support landlords' management of market risks in less buoyant areas, although policy and regulatory risk remains. Stronger housing and rental markets support a wider range of landlord business experience but, as with letting activities elsewhere, are vulnerable to negative changes in landlords' wider business and personal lives. The qualitative evidence indicates that the factors associated with buy-to-let mortgage arrears in earlier chapters are a reflection of poor buy-to-let purchases and lending decisions, combined with challenging market conditions and policy changes. Lacking experience of the letting business and an absence of personal resources to smooth income also contribute to landlord mortgage arrears.

Mortgage arrears

As in the residential market only a small minority of loans fall into mortgage arrears, and landlord representatives did not consider arrears in the sector to be a major issue. However, there are consequences in terms of churn and disruptions to the market when policy is increasingly looking for stability. Even where a receiver of rent is appointed to manage a tenancy when the landlord has defaulted, it is common for receivers to only let the tenancy run its course, and although tenancies may occasionally be renewed, the interviews suggested that this was uncommon. Furthermore, potential losses to lenders and possible serious financial consequences for individual landlords, such as poor credit scores and bankruptcy, were an obvious concern. Therefore, the risk of mortgage arrears may be small, but with potentially damaging effects.

In Chapter 3, the analysis used the English Housing Survey Private Landlord Survey data variable of 'problems with mortgage costs' as an indicator of landlords potentially struggling with mortgage payments. It is imperfect, as it is unclear how landlords interpret the question, but this indicator of potential payment stress, as opposed to an indicator of landlords with 'actual mortgage arrears' may be valuable, as the in-depth interviews revealed landlords struggling with mortgage payments without incurring mortgage arrears.

Many lenders were content that the rate of arrears on buy-to-let accounts was lower than that in the residential mortgage market. Even if the incidence of buy-to-let arrears is lower than in the residential market, and as mentioned in Chapter 2 it is unclear if this is the case, lenders must not be complacent. The landlord interview data revealed five landlords that were subsidising their property portfolios from their personal income, often heavily, with the intention of maintaining mortgage payments and preventing arrears forming. This was for a variety of reasons that included the preservation of their credit score, not least because it was common for landlords to work in financial services, where adverse credit would limit their ability to secure future employment, as well as a dislike of debt and the stigma it attracts.

The factors that led landlords into mortgage arrears reflected the circumstances of landlords whose accounts have never shown a debt (discussed below). The difference being that those landlords who avoided arrears had greater access to the resources required to subsidise their accounts, often relying on family, additional credit, wages or savings, which represented a significant burden on some landlords and many considered unsustainable.

"So in order to cope [with tenant rent arrears], what I had to do was draw on some savings that I had." Landlord 16

"I borrowed from family...probably over the last year; they've probably covered six payments, seven payments." Landlord 8

"I didn't allow the mortgages to go into arrears. I simply couldn't afford them anymore and I had to take additional borrowing…in order to tide me over a period which was very difficult. I had to use our property for further equity against that loan, and I was paying 15 per cent interest on that loan." Landlord 3

"I think I'm just at the stage though where it is affecting my home situation, what I do is just pay all the mortgages first and then we live on what's left… I think mentally, I'm finding it a drain, it's a worry." Landlord 24

Two lenders reported that another indicator of payment difficulties in the sector was landlords failing to meet their service charge payments and ground rent charges. Lenders pay these debts and add them to the loan account, as non-payment represents a breach of the terms of the leases and so jeopardises the security against which the loan is held.

"They might possibly be a warning indicator and it's something we weren't seeing that often 10 years ago, but we're seeing more often now. Sometimes, these bills are very, very substantial as well …[but] lenders will always pay ground rent and service charges arrears in order to safeguard their securities." Lender 7

"Because of financial pressures with other parts of the portfolio, people are not paying ground rent, service charges, we have to pay it; then we have to tell the borrower that we need to come to an arrangement." Lender 8

While a minority of landlords interviewed with payment problems were able to rectify their situation, often because the local market or their personal circumstances had improved, the interviews suggest that sitting alongside the formal arrears and possessions figures are an additional portion of landlords with precarious finances.

Business practices

The business nature of buy-to-let and its inherent differences to the residential market were emphasised repeatedly during the interviews, most clearly by lenders. This section scrutinises the business approaches taken by landlords in respect of their investment, and also those of the lenders in underwriting the landlords' entry in the market.

Landlords

Conceived as a business, buy-to-let must therefore be operated as one, requiring the 'due diligence' from the acquisition of the property forwards. Implicated in many of the arrears cases was a lack of prior appraisal of the market landlords were entering, as well as an occasional lapse of what might be considered to be astute business practice. In addition, some landlords had adopted one business plan at the outset, one chasing capital gains that for a short time operated effectively, but were forced to change their investment strategies significantly following the housing market and economic downturn with mixed success.

Property purchase

Many landlords were financially skilled, drawn from property and financial services, felt confident about their abilities to appraise the market and thought they had acted responsibly, although landlords with professional expertise in financial services were still represented among those in mortgage arrears and/or struggling to meet their payments. Other landlords recognised that they had accessed a limited range of advice and support at the outset. Some landlords were expressly motivated by the potential of rapid capital gains, where others had a longer term strategy to provide capital and/or rental income to sustain their current finances, provide for retirement, or wished to bequest property to family members. Landlords' skills and original motivations contributed to whether they had acquired good properties that they were able to manage successfully through the downturn.

A small minority of landlords had originally acquired property to renovate and sell for profit in a rapidly rising market, but once the market had changed they were no longer able to sell and turned to renting. The properties they had purchased were not necessarily ones that offered a good rental yield and/or were capable of attracting reliable tenants; or had been bought on high loan-to-values or high interest rates so the rental income achieved provided few surpluses. Negative equity had also impeded landlords' exits from such investments.

> *"I think a lot of it is to do with what your investment strategy is in the first place. Now people are a lot wiser, now people buy for cash flow rather than capital." Landlord 18*

The majority of the landlords interviewed were intentional landlords, although they may have started out accidentally, retaining their former home when they moved location for job related reasons for example. Former homes were also not necessarily the ones landlords would have purchased with the sole intention to let or these properties were subject to higher loan costs which occasionally meant the finances of the property were poor.

The landlords interviewed who intended to rent adopted various approaches to sourcing and evaluating their property investment. It was at this critical juncture that many of the landlords' business proposals were fragile. Several landlords relied on third parties alone for their advice such as estate and letting agents or property finders but had not appreciated all the costs and requirements involved, or the characteristics of the local housing and employment market in which they bought. One landlord, who had up to that point been a successful accidental landlord in the north, wished to supplement her income and secure her future and had bought three properties at the same time through a single estate agent who had also provided all of the mortgages:

> *"I went to one agent, which with hindsight; again, naïve is the phrase I would use." Landlord 24*

Others had not financially appraised their plans or had taken advice from agencies or organisations with a vested interest in depicting buy-to-let as an easy investment. Consequently, tenant churn, significant void periods and having to rely on tenants in receipt of housing benefit had been unanticipated. Moreover, landlords had to match properties to the target tenants, so landlords in desirable areas also experienced void periods as the properties were too small for tenants to stay any length of time. Landlords were keen to highlight that they were now aware of greater risks in the sector than they had appreciated at the outset; risks that they felt were not always apparent in media reports of the sector even now.

> *"I think when we took on the Bristol ones we didn't do our figures, we sort of went in a bit blindly, so I think a bit more attention to the figures might have, you know…" Landlord 11*

> *"People say you make your money on the way in, not when you sell…there's far more to it when you go in, the time it takes, the hidden charges, people just want to make money…People think it's risk free, but it's not, there is a price to pay." Landlord 6*

> *"Some people might not realise it but it's not just the price you pay on the property and the money you've coming in but the deal you've got on the mortgage, it's critical to how successful it will be." Landlord 15*

"A lot of this [tenant arrears/tenants job loss] goes back to the basic fact that landlords weren't necessarily buying the right properties in the right locations and putting in the right tenants. That is the key to buy-to-let success." Lender 8

One lender considered buying property at some distance from a person's home to be an indicator of risk that warranted further exploration. The analysis in Chapter 4 found buying at a distance from a landlords' home was associated with a slight increase in mortgage arrears, but may have reflected some of the areas in which property was bought rather than being a risk per se, as it did not appear in the list of factors that influenced arrears in the regression analysis. Ten of the landlords interviewed let property at a distance to their home. Occasionally, these landlords were originally accidental landlords; others were let at a distance from their home but within the same region and others had purposefully bought property at a substantial distance to their own home, originally attracted by high rental yields and rapid capital gains.

Of the latter set of eight landlords, media reports including television and friends and family were cited as sources of information alerting them to the gains to be made operating in those locations. These purchases were mostly made in the North and the Midlands, and included city centre apartments, but also apartments and houses in provincial towns and suburbs. Two landlords interviewed had used property finders or property clubs, and these and other landlords had not always physically seen the properties they had purchased. Landlords felt confident of their decisions at the time but experienced difficulties letting the properties and achieving the rents anticipated and found negative equity frequently limited their exit options.

"A lot of borrowers purchased off plan…some would purchase properties without even looking at them first and I'm not talking about pre-construction." Lender 8

"Then Newcastle was looking attractive, a high yielding area to go and invest, so instead of buying a second flat [in SE town] we went and bought several houses up in Newcastle instead." Landlord 8

"I was involved in a buying group who introduce you and you negotiate direct with the builders and negotiate discounts…I wasn't able to drive round and do lots of viewings, but was able to access these contacts." Landlord 6

"It was a piece on TV about up and coming areas, and I think there was a bit in the paper about the next hotspots and it was within our range, we couldn't afford anything else." Landlord 11

Obviously a self-selecting group of landlords were interviewed but nine of the 10 landlords interviewed who let property at a distance from their homes were either in arrears or had substantially topped up their portfolio to avoid mortgage arrears. The majority of these were managed by agents, although one was self-managed at a distance of 200 miles.

Tenancy and property management

Another issue implicated in the formation of mortgage arrears was how the landlords managed their properties and tenancies. In part it also relates to the initial research and financial forecasting undertaken, which may have omitted to account for vacant periods, routine and planned repairs and maintenance, but also relates to how landlords manage the tenancies, collect rent, set the rent and choose tenants.

There were several instances of landlords letting to a 'friend of a friend' with poor outcomes, not taking sufficient steps to assure themselves that a prospective tenant will have the ability to pay and sustain the tenancy, or not collecting rent efficiently. Landlords recognised their limitations and described their practices as *"soft"* or *"naïve"*, making bad decisions due to inexperience, but had subsequently *"toughened up"* their approach to the business of being a landlord. It was common for landlords to comment on how much they had learned and how they had over time altered their tenancy management accordingly. While some landlords interviewed were full time professionals, occasionally, sideline landlords had not entered the market believing that their letting activity was a business at all.

> *"Because it was to provide for my retirement, and from that point of view, it was not quite altruistic, but it's not far off… I would advise anybody going into the business to take those blinkers off, and think that actually, if you do this, then you do have to consider it as a business rather than anything else." Landlord 16*

> *"There seems to be a lot more competition. I think there are a lot of people who are stuck, who are actually renting out properties, as individuals rather than as a business. Because I still don't consider this to be a business." Landlord 8*

> *"It would have been nice if someone had said to me you really must get references and you really must do credit checks and things like that, but I suppose I'm a bit too soft." Landlord 2*

Many landlords were content to accept a long staying tenant paying slightly below the rental market rate, as to request a rent increase and risk spoiling the relationship with the tenant or of having a void period was a greater threat to their finances. One lender expressed some frustration with this approach as it was assumed that landlords could easily have additional rental income with which to meet the mortgage payments.

> *"Landlords should not fear putting the rent up in line with inflation because what some landlords say to us is, 'I dare not do that because the person won't want to live there anymore and I'll lose the tenancy', and it could well be that in a lot of instances landlords are obtaining under-market rents." Lender 8*

However, a number of landlords also made calculations about the level of rent the local market would stand, which in some markets prohibited a rent increase and is discussed below. Furthermore, landlords also assessed the level of repairs and maintenance required in the property and did not want to jeopardise the status of the current tenancy as they would incur substantial costs to re-let the property if it became void. Landlords had to feel confident they could replace the existing tenant, if a new rent was not accepted, with minimal void losses, and in many instances in less buoyant rental markets that confidence was absent.

Four landlords had entered into lease agreements to minimise their risks; one with another landlord who had a five year option to buy the property at a fixed price in return for a rent guarantee, and three others with local authorities, who also offered rent guarantees. These arrangements were working successfully. Another landlord leased a large portfolio of properties from other landlords and managed them with his own properties, but this was less successful and had dragged down the success of his own portfolio, mostly because the terms of the lease were not in his favour and the properties he had agreed to take on were in challenging areas.

None of the landlords interviewed had insurance to cover them for loss of income due to tenant arrears or voids periods, primarily as it was considered too costly. One landlord had successfully benefited from a letting agents' rent guarantee scheme where the agent covered the rent loss due to tenant arrears when waiting for possession to be granted in the county court.

Across the interviews landlords frequently reported having difficulties managing void periods or the replacement of white goods or repairs to properties. One lender noted that landlords' ability to obtain credit to cover unexpected expenditure like repairs contributed to the high arrears in the sector at that time. However, void periods and the costs of fulfilling landlords' repairing obligations are not unexpected and should have been anticipated at the purchase stage, although the inability to fund such work was also hampered by the changing market conditions after purchase that disrupted landlords' finances.

> *"I tended to carry out repairs and improvements using credit cards, zero interest, good credit rating, and remortgage property and get rid of the credit card and raise funds for the deposit on the next property. That's how I was building my portfolio of properties. When the housing market crashed all that stopped. I'm now in a debt management plan with my credit cards and having difficulty with the mortgages." Landlord 2*

Moreover, once the finances become constrained then it becomes harder for the landlord to fulfil their obligations and juggle all demands made of them. One struggling landlord acknowledged that her properties compared poorly to similarly priced properties locally but she could not afford to refurbish them, and consequently experienced difficulties letting them, compounding her financial problems.

One landlord provided an overview of her portfolio illustrating the financial constraints many experienced without even experiencing tenant arrears or void periods (Table 5.1). Even where rental income covered their mortgage payments – which was not the case in seven of the 25 landlords interviewed- there were often insufficient surpluses to provide funds for repairs or the replacement of white goods, or cover other external shocks to the letting business. This landlord had bought three of the properties as an investment to smooth an anticipated drop in wages and to secure her future using the equity from Property D – which she had inherited, remortgaged and improved – as deposits. Note that the table does not include funds for repairs and maintenance of the properties and the portfolio generates little income to accrue surpluses to cover these expenses, void periods or tenant arrears, or other 'shocks' to the business. This landlord has tried to renegotiate the interest rate on the mortgage for Property B but was unable to do so. The loan-to-values were originally 85 per cent, but now the landlord estimates that the three purchased properties are now in significant negative equity.

Table 5.1: Financial overview of portfolio (Landlord 24-town North West) (£)

Development	Property A	Property B	Property C	Property D	Total
Purchase Price	153,425.00	126,947.50	94,307.50	0.00	392,680.00
Purchase fees	7,034.58	5,133.02	4,154.53	796.08	17,118.21
Renovation costs				30,000.00	30,000.00
Remortgage fees				1,020.37	1,020.37
Deposit Paid	8,671.25	6,847.35	5,215.35	18,000.00	38,733.95
Investment costs	15,705.83	11,980.37	9,369.88	49,816.45	86,872.53
Acquired	2007/8	2007/8	2007/8	Inherited (former home)	
Mortgage Advance	130,411.00	96,947.00	80,160.00	88,000.00	395,518.00
Repaid by	31/07/2027	31/07/2027	31/07/2027	25/06/2040	
Balance outstanding	131,750.11	98,397.98	80,996.60	88,738.40	399,883.09
Type	interest only	interest only	interest only	repayment	
Rate	2.505%	4.790%	2.505%	2.500%	
Mortgage Payment	275.03	391.30	169.08	378.56	1213.97
Insurances	13.33	13.33	13.33	16.12	56.11
Ground Rent	22.84	16.67	12.50	0.25	52.26
Service Charge	100.00	61.83	115.00	0.00	276.83
Safety checks	5.00	7.50	5.00	7.50	25.00
Letting Agent Fees	24.90	24.90	45.00	24.90	119.70
Monthly Payments	441.10	515.53	359.91	427.33	1,743.87
Monthly Rental Income	550.00	495.00	375.00	500.00	1,920.00
Monthly Profit / Loss	108.90	-20.53	15.09	72.67	176.13
Yield (author calculation) (%)	0.8	-0.2	0.2	1.8	0.4

Another source of frustration for this landlord is the high service charges for Property C. Property A has a similar service charge but has electronic gates and a lift, but Property C has no attributes or significant grounds that would warrant such a high charge, which also has to be paid annually in advance. Other landlords repeated complaints about management companies' ability to control service charge costs for flats, over which landlords felt they had little control. The costs had sometimes risen substantially since the original purchase. This landlord has experienced many void periods as well as tenant arrears and has been subsidising her portfolio from her modest wages, and so has not accrued any mortgage arrears, but the financial strain was a source of great anxiety. The figures will differ but the circumstances are illustrative of the pressures on other landlords who were struggling or had mortgage arrears.

Lenders frequently, but not universally, considered regular risks of letting activities to be the most significant drivers of mortgage arrears in the sector. Some of this reflects the local economy and demographic from which tenants attracted to the landlords' property are drawn, and therefore may relate to the initial purchase, but also to the landlords' prowess in undertaking rent collection and other landlord activities.

> *"I would say the most common instances we see are probably tenants' arrears, where they're not paying the landlord. Probably next along obviously would be repairs on the property and therefore they can't pay the mortgage this month because we have to carry out the repair. And then obviously voids latter to that." Lender 1*

> *"A steep learning curve and an awful lot of mistakes at the start…I was far too generous and lenient on people who took advantage." Landlord 3*

> *"I then got a tenant as a favour to somebody I worked with who did quite a bit of damage…I stupidly took on somebody as a favour to somebody else. I think I've been an easy touch for people in that way." Landlord 8*

Landlords regularly expressed the view that the law sided too much with tenants, but constrained finances also limited a landlord's ability to effectively collect the rent, as several landlords complained about the cost of taking a tenant to court for rent arrears.

> *"I've not gone to court; I've not got that much money. First a solicitor is £550 just to look at the case, even for a shorthold assured tenancy, all the letters and notices. Then it's £750 for the legal fees, then there is the court hearing, the court charges £150 for hearing the tenant making arrangements with the judge. Then all the legal action is stopped and it's still not guaranteed they'll pay. Roughly calculated its £1200/1250 and your nerves, it's just not worth that." Landlord 17*

Another key issue with tenant rent arrears were problems relating to housing benefit, which is discussed below.

There were three self-defined professional full-time landlords and one professional, who also had another job, interviewed who operated successfully in the North East and North West who demonstrated that they managed their properties effectively in sometimes challenging locations. Their portfolios included lets in the housing benefit submarket. These landlords routinely networked with local landlord forums, attended landlord seminars, used the internet, tightly controlled their finances and tenancies, kept abreast of their obligations and of the local market and adjusted their portfolios and management practices accordingly. Good tenancy and property management did not overcome difficult market conditions in all cases, but is obviously essential to mitigate external risks to the landlords letting business activities. One landlord in Manchester had a high proportion of transient tenants who left large quantities of unpaid creditors in their wake when they left but paid their rent.

> *"You have to be in at the start, get them to realise they have to pay the rent" Landlord 25*

As reported in Chapter 3, a minority of landlords used agents to manage properties, but the use of agents was not associated with fewer landlords reporting problems with mortgage costs, although it did reduce reports of tenant arrears. Indeed, the landlord interviews demonstrated that agents were used at a cost and represented an independent risk, as the investment was being managed at arms-length. Several landlords experienced more vacant periods than they felt were necessary due to the slow response of agents, incomplete repairs and delays in passing rent payments to landlords, threatening precarious cash flows. As they became more experienced landlords had commonly assumed the tenancy and property management themselves, although many retained agents for finding tenants.

> *"I don't particularly like letting agents. Having to deal with them through my job, I found them quite defensive or downright difficult, and I didn't think that they were particularly a good way of finding out truthful information." Landlord 8*

> *"I started using an agent and found them massively incompetent that I got rid of them and moved to a different agent who turned out to be even worse." Landlord 18*

> *"When things have gone wrong and I've asked to see the references that they collected, to find that they hadn't collected any at all, so I think I can do better for the tenant and my own security by doing it myself, really, and save money." Landlord 19*

> *"[Landlords] put all their faith in agents, sometimes they'll be lucky, sometimes unlucky, they're probably also naïve in choosing the agents. We support the regulation of agents." Landlords' representative 1*

Agents were regularly used when landlords let property at a distance. While complaints about agents' performance was common across the majority of interviews, landlords who lived in the south and let properties in the north of England were particular critical about the agents' ability to let the properties effectively. However, it was unclear whether some of these problems were a result of poor management or reflected structural problems in local housing markets with over supply of rental property and low tenant demand. In addition, agents did not always serve the submarkets that the properties lent themselves to, such as the housing benefit market.

> *"You know in both circumstances, in Bristol and up north, the agents say 'the market is really buoyant we won't have any trouble letting it'. In Bristol you'd get phone calls after phone calls and then all of a sudden, you've got a number of tenants who are prospective and you get to choose, whereas up north, if I didn't ring them, I'd never get a call." Landlord 11*

> *"At some point an agent had persuaded me to let it through them and in three months they had one person who dillied and dallied and so I took it off them. I advertised it myself for £100 per month more than they were advertising it and had 14 enquiries and 14 actual viewings arranged in two weeks, and nine people turned up and 8 of the 9 wanted it!" Landlord 2*

> *"They're not managing their portfolios correctly. They might not have bought in the right location and they can't manage it closely; or having the wrong tenants in, and that's what it's about. It's about being able to manage your properties on a regular basis to see what's going on and you can't do it at arm's length." Lender 8*

Lenders

Lenders were able, with hindsight, to recognise their own failings in the buy-to-let market that also contributed to arrears. While landlords carry responsibility for any poor market appraisals and purchasing decisions at the outset, lenders also underwrote these loans providing some validation for the landlords' proposals.

In Chapter 4 the analysis found that loans advanced at the peak of the housing market were over-represented among accounts in arrears, and the interviews with lenders and landlords suggest that the quality of some buy-to-let lending contributed to the propensity of some of these loans to fall over. Indeed one large lender noted that they went into the recession already carrying significant buy-to-let mortgage arrears, even prior to cessation of their lending in this market and the full impact of the downturn becoming apparent. Interviews with landlords demonstrated the ease with which buy-to-let loans were obtained up to the market crash. Some landlords reported more detailed checks than others but overall there was ready access to mortgage finance and competition between lenders to offer those funds.

> *"Yes in 2004-5 they were throwing money at us." Landlord 14*

> *"Normally we wouldn't have been given such a big loan, which was £124,000, because my husband was earning less than £20,000 at the time…But because of the amount of equity in our main residence they allowed it." Landlord 16 (on incapacity benefit)*

> *"It got harder as we couldn't get the almost 100 per cent mortgages that we could get until mid-2008…yeah, we got very high lends." Landlord 20*

> *"I worked for the local council on a 20 hour a week contract at the time and I wasn't earning loads, I wasn't a Chief Exec or anything, you know, I was an administrator… The fact that they gave me three, you know, a re-mortgage and then three further mortgages." Landlord 24*

Further illustration of the ease with which buy-to-let loans were advanced are the two landlords interviewed who used credit cards to fund the deposits and that two others were on low incomes and/or in receipt of benefits. A large proportion of landlords with multiple properties purchased them using equity released from other properties, recycling their initial deposit through their portfolio. In rising markets this was not problematic in terms of lending as loan-to-values were falling, but once the market stalled, landlords were left highly leveraged.

Lenders varied in their appetite for involvement in the growing buy-to-let sector. Those lenders who wished to be involved but had adopted a conservative approach to the buy-to-let products they offered noted that they had experienced arrears below the market average. In contrast, other lenders in the period prior to the financial crisis had relaxed lending criteria significantly to capture a larger share of the buy-to-let market. Large lenders increased loan-to-values to 85 per cent, but also offered 100 per cent loan-to-value products, which could be used in conjunction with reduced rental covers of 110 per cent or even 100 per cent in some cases. Moreover, such loans were not necessarily priced to match the increased risk.

> *"Everybody was embroiled, and that applies to every buy-to-let lender. People were embroiled in the race to be number one buy-to-let lender in the market." Lender 8*

> *"At times there were instances, particularly during 2007 where the market was still in a growth mode, so before it hit the crisis, where the 100 per cent [rental cover], 85 per cent LTV products were priced lower than your 125 because they wanted the volume." Lender 4*

Lenders were able to approve loans and were keen to advance funds as long as basic criteria were met, meaning that prospective landlords were able to obtain funds with minimum personal resources and security. As the loans were commercial products there was often a lack of scrutiny in respect of the personal resources available to the landlord and only a reliance on the valuer to confirm the sale price and proposed rental income were reasonable. The rental valuations were not always achieved, and, in a minority of cases, had never been achieved.

> *"I was quoted, you know, I would get £700, £725 rent there and I get £550." Landlord 24*

Lenders mentioned problems with incorrect or negligent valuations and discounting practices in particular markets but viewed these as isolated events. It is likely that valuers themselves were just as 'embroiled' in the market exuberance of that time as lenders and borrowers.

Significant mortgage market players did withdraw from certain market segments prior to the market crash, thus limiting their exposure to poor quality loans and subsequent mortgage arrears and possessions. The analysis in Chapter 4 found that loan accounts held by landlords with large portfolios were more likely to carry arrears. The interviews confirmed that landlords with multiple properties pooled their rental income and paid outgoings from the one 'pot', often subsidising some properties from across their portfolio, or occasionally choosing which loan to default on depending on previous arrangements made or the relative costs. Although there was also acknowledgement that risks arising from a single property could be spread across several properties several lenders were wary of landlords with larger portfolios.

> *"There were instances of professional landlords over-stretching themselves and worsening financial circumstances. We saw arrears rates go up and the guys crystallised their losses. They were professional landlords, over-geared, over-leveraged; not robust enough to cover losses and void periods when unemployment started to rise." Lender 3*

> *"But there's no real rationale …actually those people [landlords with multiple loans] are more likely to pay than people that have got one buy-to-let" Lender 6*

Failure of these accounts means the lender is exposed to greater losses. Subsequently several lenders already in the market implemented caps on the number of properties or loans held and new entrants have adopted this cautiousness. Indeed, some landlords reported that new ceilings on the number of properties or loans held was now a concern as it inhibited any planned expansion of their portfolios.

Some lenders curbed their exposure to significant lending on city centre apartments prior to the market peak. A higher incidence of mortgage arrears is associated with flats in some regions in the analysis in Chapter 3 and 4. Lenders also limited the number of loans within individual developments as should default occur and the properties be repossessed then disposing of several flats at once would depress their price and ensure the lenders would incur greater losses. Flats in themselves were not inherently risky, but their purchase did symbolise the exuberance of the market at its peak with all its associated strengths and flaws.

> *"[It] was felt to be a higher risk market, and that was also where the property clubs were very much involved I think, and the building blocks of flats and everything and then trying to sell them on. So we pulled out of that market." Lender 1*

Several lenders maintained a prudent approach to buy-to-let throughout the cycle and reported that they had below market average arrears on their buy-to-let book. Others had adopted a more stringent approach to lending in the buy-to-let sector since the crisis, or have renewed their interest in the market on the basis of chasing small individual investors with one or only modest holdings, and sufficient personal resources to absorb any income shocks associated with their letting activity. Furthermore, two lenders interviewed have adopted processes that exclude landlords whose activities suggested that they were adopting a model of chasing capital gains rather than rental income, indicated by operating through property clubs and buying at a distance from home, and were looking for long term sustainable loans.

> *"The new lenders that have come into the market, like ourselves, post the credit crash, have come in wanting to, accepting it for a commercial proposition, but wanting to actually just do a few more checks to make sure that if problems arose again, how could the applicant support the mortgage?" Lender 6*

> *"There's a variety of things we did during 2008, which meant that we were looking for a much more vanilla proposition, vanilla type investor." Lender 3*

Immediately following the crash the loan-to-values were reduced to a typical 65 per cent across the market. However, as appetite in the market has grown there has been some relaxation of the prudent post-financial crisis lending terms and loan-to-values are beginning to rise again.

Several lenders firmly expressed the view that underwriting quality loans secured lower arrears across the book. This echoes the landlord representative's views about the quality of the landlords' appraisal that goes into the initial buy-to-let property purchase producing more stable and effective lettings.

> *"There is a direct correlation between the clean book…and the controls at the front end." Lender 5*

> *"You don't solve arrears at the back end, it's an output of underwriting, the risk approach of the organisation. The danger I think is owner-occupied lenders thinking buy-to-let lending is a bit like it, it isn't. Have to understand it's a business transaction…. It's about getting it right, understanding the risks in the buy-to-let market." Lender 2*

Overall the interviews emphasise the importance of lenders also critically appraising landlords' business proposals and exercising due diligence at the outset, which would go some way in limiting mortgage arrears and exposure to market risk.

Market change

The UK contains highly divergent local housing market experiences, often rendering national aggregate housing market data limited in its application. Local markets are influenced largely by the local economy and the legacy of the past and will include different configurations of private rental sector submarkets. One respondent cast doubt on some of the market intelligence available to landlords as it is fuelled by industry 'vested interests' who benefit from positive market reports. Reading the local market and understanding local shifts can therefore prove challenging for landlords (Wallace, 2008). Nevertheless, to manage their investment landlords are required to consider changes to house prices, tenant demand, rental values, the mortgage market, as well as policy shifts that may influence their business and steer their letting activities accordingly. Landlords try and overcome the knowledge deficiencies of the market by letting close to home (Crook *et al.*, 2013), although the interviews suggest that this strategy is not fool proof. As set out above, some landlords entered the market without wholly acquainting themselves of all aspects of their business. Even when landlords did undertake extensive research prior to their purchases, market instabilities induced disruptions to landlords' business plans and were associated with the incidence of mortgage arrears. One landlord who was an accountant calculated that by his worst year during the recession he had up to then lost £40,000 because he held fixed rate loans in a period when rental income declined. He set out his reasons for mortgage payment problems:

> *"I have no control over these fluctuations; they're directly influenced by the rental market, mortgages rates and interest charges. I had no void periods, no exceptional costs, and no tenant arrears." Landlord 2 (Six properties in South East England)*

The most significant contrast in experiences was between landlords who held property in the south and those in the north of England, although this represents a crude characterisation of the housing market as there are also buoyant markets in the north and weaker markets in the south. Indeed, there were several reports of the improvement in the city centre apartment markets in locations such as Manchester and Leeds. However, inter- and intra-regional disparities remain. For example, one landlord in Scotland drew the distinction between her experiences of the Edinburgh market, which were positive and those in provincial towns in Scotland's border region where tenant demand and employment prospects were weak, and where consequently, her letting activities were more problematic.

Landlords who let in the south of England did report some downward movements of rent immediately after the financial crisis began, but have since seen rents recover or exceed their previous position. Vacant periods were minimal if non-existent as there was strong demand for private renting. Professional landlords engaged successfully in some niche submarkets such as asylum seekers, migrant workers and housing benefit, but on the whole landlords could draw tenants from a large pool of secure working people in skilled employment. These landlords also held equity in their properties and although some did acknowledge that they had made mistakes along the way were able to exit their investments by selling or switch mortgage providers if they desired.

> *"I always seem to let to single men, there are quite a lot of big companies in Swindon; Honda, mobile phone companies and things and I think people stay there in the week and go other places at the weekend…I've always been full, even at changeover; I've never had a void period." Landlord 13 (Swindon)*

> *"We don't have any void periods. Since the recession there's no churn in tenants. I think that's something to do with benefits as well but nobody moves. Honestly, I've let one property in the last year and that was because a tenant went into a nursing home." Landlord 14 (Bristol- 45 properties)*

> *"We've been lucky, we haven't had properties empty. Well, I've got one empty now, but that's the intention only because we've placed the property on the market to sell." Landlord 10 (Bristol)*

In contrast, landlords who let in more challenging housing markets in the North or Midlands in some instances had experienced weaker tenant demand, falling rents, declining house prices and a greater reliance on tenants in receipt of housing benefit with the associated problems of administration and payments and, in these locations, high tenant turnover as alternative rental accommodation was readily available. Consequently, increased voids and tenant arrears meant that the finances for individual properties no longer stacked up and no additional income could be obtained from the rent, making cash flow extremely difficult and exerting pressure on the buy-to-let mortgage payments. Most critically, negative equity prohibited landlords from selling the properties.

> *"[Tenant demand] was very strong at the beginning and around 2009/2010/2011 it went very quiet. It was very hard. Properties were empty for long periods of time. There was actually only one…I think there was only one month of these past seven years, six years that all properties were let." Landlord 20 (Manchester)*

> *"I think there's a population of people who have tried to retain [their properties] and ended up in a position with negative equity and I think what we tend to see is that there's an over-exposure of opportunity for rental properties now in certain areas. So, in the south-east they tend to be okay because there's lots of people trying to find rental accommodation in there, but when you look at different areas across the country it can be very different." Lender 4*

> *"In an area of Sheffield I had a couple of two bedroom properties, two bedroom houses, and at one point I had people queuing up to move in and now when they become vacant I can't give them away." Landlord 2 (Sheffield)*

> *"It's rare to avoid a void. If someone moves a two months void is typical before I find someone to move in…all rents are less than in 2003. I don't put rents up as they just find somewhere cheaper, it's competitive." Landlord 13 (Cumbria)*

Once finances become strained the situation can quickly escalate downwards, and be difficult for the landlord to control:

> *"If you're tight on cash anyway then you haven't got the money to go and spend as and when you need to on property maintenance. That then can lead to a disgruntled*

tenant or a bigger property issue and then if the tenant moves on and you've got a property that's got issues you can't obviously attract a new tenant in there and it spirals a bit. That can go on for a very long period of time, it's not just a one month thing." Landlord 18

Buoyant markets can mask poor performing letting activities as equity can enable landlords to exit their investments. Lenders in other areas may be able to sell at least one of their properties to remedy default, but such routes out of arrears were less clear in other locations.

"They've got a substantial amount of equity that in most cases will clear all the arrears and give them a cushion going forward and it effectively wipes their slate clean." Lender 8

Others, especially professional or semi-professional landlords were very effective in networking and drew on any support available such as the local authority landlord forums and property seminars. These landlords were able to astutely navigate the local housing market and operated their letting activities successfully.

Landlords' personal circumstances

Among several of the landlords' accounts of the factors that led to their mortgage arrears or their struggle with maintaining the mortgage repayments were issues unrelated to their property and letting activities. In these cases there may have been some disruption to their property cash flow, but largely the issues related to their other business concerns and/or their personal life. It is commonplace in the residential mortgage market for the major trigger events of labour market disruptions, ill-health and relationship breakdowns to present in combination leading to prolonged adverse circumstances and mortgage arrears (Gill, 2009; Policis, 2010; Ford and Wallace, 2009; Ford *et al.*, 2001), but as buy-to-let is a business proposition these events are unexpected in this arena.

Three of the landlords interviewed had experienced relationship breakdown that played an instrumental role in the formation of mortgage arrears. In one case, limited growth in another new enterprise and the stress and mismanagement of the tenancies on the part of their former partner had led to divorce. The two other cases were woman left holding property following their divorces. One had given power of attorney to her former husband who had purchased properties in her name, and was left with stock that her husband could not sell in the falling markets following the crash, causing her great anxieties. In the other case, the husband had assumed residence in the property that had produced the greatest profit, undermining the finances across the remaining weaker stock in the portfolio. Falling rents and/or significant void periods created debts, and negative equity meant that these landlords could not exit their situation and were facing bankruptcy.

Similarly, some combinations of events were also apparent, relating to the changing market, their personal finances and wider business management. The difficult economic environment arguably enhances the possibility of multiple factors occurring at once.

"I ran the [non-property] business for a couple of years and realised it was going downhill, so I had to cut my losses. During that time I was propping up the business with some of my rental income and consequently I got behind on paying some of them." Landlord 22

"I guess I lost my job. Yes, I was going through a very difficult relationship period as well...I mean I guess I knew I was going to struggle with the mortgage and…I had very little savings at that time and some of my bank accounts were actually frozen because of the trouble I was having in my relationship." Landlord 19

"It was the fact that I had one tenant who had ended up getting into quite big arrears; it was at the time my mortgages were costing more, plus the fact I couldn't change them

because I was ill [out of work]. So there's lots and lots of things that have happened. I think if any of them had happened on their own it would have been fine, but happening together has caused a bit of a tsunami, really." Landlord 8

For some lenders, landlords' own personal business failings and mismanagement of their money was considered to be a key factor in the origins of mortgage arrears in the buy-to-let sector. Evidence from landlords certainly demonstrates that non-property related factors contributed significantly to the incidence of mortgage debt. Almost all lenders interviewed thought landlords prioritised maintaining repayments on their residential home over their buy-to-let mortgage. Full-time landlords who experienced arrears were drawing a salary from their letting business, one said this was *"not much"* and another was in receipt of income-related benefits, but it was unclear to what extent the others may have used the rental income to support their own households.

"If a landlord is themselves in financial difficulty and they have one buy-to-let and one residential mortgage, very often they'll use the income from the rent to start to pay the [residential] mortgage. It's the one property they live in so the one they care about the most. And that is typical of non-professional people like you and me, people who did buy-to-let because they saw someone doing it on the TV." Lender 3

"But what we do see, the rent being used to subsidise a lifestyle." Lender 1

"In the event of arrears, it may not be, but typically it is not the property that generates the problem; it's rarely an unviable or unsustainable rental property. It's the business life or the private life of the customer." Lender 2

As discussed in Chapter 2, while survey evidence shows that the majority of landlords are wealthier than the general population (Lord *et al.*, 2013), several landlords had modest incomes and no personal resources to draw on, possibly explaining the temptation to use rental income to support other expenditure in a crisis.

"Small landlords are investors but they're not particularly wealthy, they're not hard up…but they're not rolling in cash. Once the income's stopped, the investment stops, there's no operating cash and the investment can decline in condition." Landlord representative 2

"The buy-to-let industry seems to have the attitude that if you have more than one property you're obviously rich, you can afford to deal with the tough times, but it just isn't like that. The tenant was surprised when I turned up in my old Renault Megane and wasn't in a Land Rover…it's just normal people trying to make something of themselves." Landlord 4

The diversion of rental income to fund other parts of the landlords' finances explains lenders' reports of landlords being unhappy with the appointment of receivers as they no longer have access to that income and the rental income stream is used to service the mortgage.

Routinely or occasionally supporting the buy-to-let activities from landlords' own income was evident in 15 of the 25 landlords interviewed, some successfully avoided arrears and others less so. However, one landlord representative did not consider personal reasons for mortgage arrears as ever being valid, as buy-to-let should be a business proposition:

"Should not be looking to pay buy-to-let mortgage [out of own money], it should stand on its own two feet as a commercial business decision. They should do their homework on the market, location, tenants, rents achieved, levels of demand, assess the property itself, costs of repairs or refurbishment or improving, can it meet the lenders' conditions? Does it have reasonable prospects of that market will remain?" Landlord representative 1

Regulatory or policy change

Mortgage policy

As a consequence of broader market phenomena, some lenders have taken strategic decisions to reduce exposure in the mortgage market or alter prices to reflect more recent costs of borrowing and risks. The ramifications of this are reflected in lenders calling in loans, as they wish to dispose of the loan book in its entirety, even if no breaches of the mortgage have occurred.

> *"The reason they want their money is that they were bought out by [name of global bank] who have decided to curtail their, what they call, high risk investments…The arrears have only started since then because I can't afford to put money into properties that I know are not going to be mine in a couple of months' time". Landlord 20*

In this instance, there was no breach of the loan terms but the lenders' action pre-empted arrears on the loan accounts, as the landlord stopped paying as the properties would need to be sold and shortfall debts negotiated with the lender.

Other lenders changed their management practices over the period of the market downturn, initially supporting the best outcomes for borrowers and lenders, but moving towards a rapid repayment of the loan book, thus adding further disruption to landlords' letting plans. Lenders have case-managed high risk accounts and where landlords display a pattern of carrying low-level arrears on their account that would not warrant formal recovery action, one lender has sought to use breaches of loan terms such as failure to pay service charge or ground rents to call in these loans. Using clauses in the mortgage terms to increase mortgage rates beyond the headline tracker values for professional landlords, as two lenders have recently done, also represented a risk to some landlords on fragile budgets.

> *"It took us about three or so years to get back to where we needed to be [but] now it's very commercial driven. They've got these commercial managers whose sole job is to go and close what they can and redeem what they can and that's quite a worrying thing for a lot of landlords." Landlord 18*

> *"The [name of lender] have done that, push up the mortgage, but I can just about cover that with rent. But if any of the others do that I would have to take the hit of negative equity, I'm going round in circles" Landlord 6*

Clearly, as in the residential market, the falling interest rate from 2008 onwards saved many buy-to-let landlords as their interest only loan repayments reduced substantially if they had tracker or other variable rate loans. Landlords had often benefited from their lenders' standard variable rates as many were set advantageously to the borrower prior to the crisis. For a minority of landlords, they were unable to benefit from the rate reductions as they had taken out fixed rate loans, which became problematic when rents dropped, and tenant arrears increased, so their mortgage costs had remained unchanged but rental income was lower.

Many landlords talked about the problems of being a 'mortgage prisoner' and being unable to re-mortgage to release equity or to chase better interest rates. This is due to their impaired credit or possibly more simply that they were now carrying too high loan-to-values, including negative equity. Chapter 4 saw how often loan-to-values had increased since the loans were originally advanced suggesting, on this basis alone, that half of landlords could be excluded from re-mortgaging. While not all landlords were unhappy with their current interest rate, some declaring it to be a *"bargain"*, a minority of landlords had requested that lenders move them on to more favourable interest rates to help alleviate pressure on their finances but had been refused. This issue may increase in significance when rates begin to move upwards.

The interviews suggest that interest rate rises when economic conditions and unemployment indicators improve is likely to have a significant impact on the sector. Landlords currently struggling with mortgage payments were not confident that they could manage increased interest rates. Some landlords indicated that they could cope with significant rises, rates up to 10 per cent, but generally past a couple of percentage points, some landlords who were already struggling thought they would feel pressured to exit the sector. Increased interest rates could also disrupt the arrangements landlords have made with lenders to repay arrears debt.

> *"That would have a detrimental effect, I could cope up to five per cent." Landlord 12*

> *"Depending on the quality of the stock it wouldn't take much to knock over or for a number of portfolios to fall over. It could be something like half a per cent base rate rise and some of the buy-to-let market could be in trouble." Lender 8*

The other option landlords could pursue should mortgage interest rates rise is to raise the rents. As discussed earlier, landlords and lenders noted the reticence that many landlords felt about increasing rents for existing tenants. There are also limits on what the local markets will withstand, not least in neighbourhoods where the only tenants are those in receipt of benefits and the rents are effectively capped.

Although many lenders anticipated a growth in accounts 'falling over' into arrears as a consequence of interest rises there was a sense that as it is not the landlords' own residential property at stake, landlords would be able to sell up and exit the sector should the property or portfolio if the viability is challenged. Exiting a poorly performing investment in buy-to-let was a balance, however, between coping with higher mortgage costs and limiting potential losses from negative equity in some locations. It is uncertain what sequence of events will play out in different locations, but it is possible that bank base rates rises may undermine any heated housing market activity in the south prior to any substantial economic, housing and/or rental market growth in weak locations in the north, with adverse consequences for landlords in some places. For a minority, lenders and landlords could suffer some losses when base rates move.

> *"I know some have already gone bankrupt and I know some who had to sell quite a lot of what they had at low prices. I think it's going to be an absolute mess when rates go up." Landlord 8*

The resistance to the two banks that have recently raised interest rates outside the headline terms of the mortgage for tracker and variable loans taken out by professional landlords with five or more properties[5], may reflect discontent with the lenders invoking little understood terms in the loan contracts, but also indicate the brittleness of some landlords' finances.

Housing Benefit

A key question has been the impact of housing benefit on buy-to-let landlords' finances and subsequently on mortgage arrears. Many lenders prohibit landlords from letting in this area due to the perceived risk. The EHS-PLS data was collected in 2009-2010 and the analysis in Chapter 3 demonstrated an association between landlords reporting problems with housing benefit administration and reporting problems with mortgage costs, although having a tenant on housing benefit was not in itself an important indicator of problematic mortgage costs. The interview evidence shows that some landlords make successful letting businesses in this part of the private rented sector but it requires additional skills. Frequent problems with housing benefit threaten cash flow, which many inexperienced landlords and/or landlords with weak finances struggle to overcome. One landlords' representative noted that the housing benefit segment of the private rented sector was one of the most profitable but required experienced landlords. He observed a flight away from the housing benefit market among landlords and feared less capable landlords would enter this sector seeking high yields but be less effective at managing this stock and its tenancies.

5 *http://www.telegraph.co.uk/finance/personalfinance/borrowing/mortgages/10462168/Regulator-warns-tracker-rate-rises-could-be-unlawful.html* [Substitute for FCA warning consumer protection alw]

Fourteen of the landlords interviewed had experience of letting to tenants in receipt of housing benefit and ten of them reported problems with non-payment of rent by tenants who had received housing benefit directly; shortfalls in payments due to the reduced maximum rent levels and the benefit cap; administrative delays; the new single room rate for people aged under 35 and the repayment of overpayments. Four of these landlords who had incurred tenant arrears due to housing benefit related problems had mortgage arrears and two were struggling to maintain their mortgage payments.

The most frequent complaint, from almost all of the landlords as they gathered cumulative experience of housing benefit, related to the shift towards housing benefit being paid directly to tenants, not least when after significant administrative delays substantial sums were issued and tenants had not used this money to pay the rent. Several landlords interviewed had experienced this, often followed by protracted liaison with the local authority to get payments made directly to the landlord as the regulations permit for payments to the landlord if tenants are 8 weeks or more in arrears. A minority of landlords also reported tenants abandoning the properties shortly after this and suggested that a minority of tenants do this repeatedly to obtain the money.

> *" Had cases from the local authority before and they take forever to set up the rent…I can't wait for the cheques. Every week or month is crucial to me." Landlord 17 (Scotland)*

> *"They know the tenants they're dealing with. I'm not sure why they think that's [paying tenants direct] is responsible. I mean I imagine it was because some landlords were just neglecting their properties." Landlord 20 (North West)*

> *"You can guarantee they'll drink it, they'll spend it, they'll smoke it, whatever, and they'll just move on to another property and start it all over again and the council just pay up every time." Landlord 21 (North East)*

Sideline landlords often struggled financially from non-paying tenants, but other professional landlords adopted strategies to overcome the challenges in the sector. These strategies to make the housing benefit part of the market work included using guarantors to act as additional leverage on the tenants' behaviour, as well as a third party to chase for unpaid rent or the costs of repairs arising from damage; chasing tenants rigorously to make up the shortfalls in rent; asking tenants to overpay the rent to build up a 'buffer' or deposit to cover unpaid rent or damage; or routinely requiring all tenants in receipt of housing benefit to write to the local authority declaring that they could not manage the money and requesting that all payments should go direct to the landlord from the start of the tenancy.

Several professional full-time landlords specifically targeted this submarket but other landlords were unable to attract other tenants to their properties, because of the type, condition or location of the property, or their tenants became unemployed.

> *"You can't avoid it [letting to tenants on housing benefit]. You can have the nicest house, which I do on a very quiet street and nobody wants it beside housing benefit." Landlord 20*

Not all tenants in receipt of housing benefits were problematic, and in the south, one landlord – in fact the only landlord interviewed based in the south that routinely let to tenants in receipt of housing benefit- considered a lone parent on benefits to be the ideal tenant, as the rent was secure and, in his local market, they stay a long time. However, one landlord in the North West targeted families on benefits as initially he thought they would be more stable and stay longer in the property. However, regardless of the number of children he found these families were just as likely to abandon the property after a few months, and estimated that between 60-80 per cent of his tenants, including families, were serial movers. He also experienced four tenants subject to the benefit cap on larger properties. One was also in receipt of disability benefits so it was lifted, on two occasions he reduced the rent for the tenant by £80-£100 a month as they were unable to pay the extra sums, and one property he sold with the tenant in situ. He now plans to move away from four and five bedroom properties to avoid this issue in the future and has bought more two bedroom properties. A landlord in Sheffield had tenants move out of one bedroom flats due to the increase in the age limit for the single room rate, and had swapped his larger properties where tenants were subject to the benefit cap to HMOs. Another landlord experienced a tenant subject to the benefit cap and the tenant got a job but may still lose the home due to further rent arrears accruing. A professional landlord in the North East noted increased rent arrears across his portfolio that have arisen only in the last year but routinely requests that tenants pay the benefit shortfalls.

The interviews demonstrated that landlords had to be deft to cope with the more intensive management of tenancies in this submarket, certainly in the early stages of any lettings. Moreover, the interviews did not specifically see landlords exiting the sector, although often this was due to negative equity and a lack of choice about whether to persist until the market rises, but the interviews showed some concern about the direction of benefit reforms, and some sea-change in the way landlords were approaching the market.

> *"You just need to be knowledgeable in what you're doing" Landlord 21*

> *"The country needs to accept housing benefit tenants as councils can't accept them as there's not enough houses. If they paid landlords, the people need a roof over their heads, so if they treated landlords better they'd accept housing benefit tenants." Landlord 25*

> *"It doesn't make me more or less interested [welfare reform]. I certainly wouldn't hang my hat on renting to local housing allowance people. If I had a choice I wouldn't let to any to be perfectly honest…so yes if I had my time again I would have a completely different strategy for investment." Landlord 18*

Many buy-to-let mortgage terms restrict landlords letting to tenants in receipt of housing benefit, although many lenders took a pragmatic view acknowledging that tenant circumstances may change or that the landlords may not know the tenant would be in receipt. Some lenders went as far as relaxing these criteria altogether in recognition that the private rented sector needs to accommodate low-income households. However, there are indications that housing benefit policy itself currently represents a greater threat to the provision of homes to these households than lenders' policies as landlords find aspects of this segment increasing challenging.

The advent of Universal Credit was not yet on the horizon for most landlords interviewed. Landlords advocate organisations were concerned with negotiating switch back arrangements for tenants who fall in arrears, to ensure that the housing element could be redirected to the landlords. Among individual landlords, however, there was some concern but largely ambivalence about what the impact might be:

> *"So yes with the welfare reforms I think again that could be quite a lot of mess, but then why should it be, in a way, because some people are going to get the same sort of monies they've had before, just in a different way. It is definitely a tricky one." Landlord 18*

Selective licensing

In Chapter 3, letting in areas of selective licensing was initially associated with landlords reporting problems with their mortgage costs, but fell away in the regression analysis suggesting that licensing itself does not have an independent influence over arrears. Although the landlords interviewed found the costs of licensing unwelcome and benefits uncertain, it is likely that letting in such areas reflected the task of letting in the housing benefit market and in more challenging market locations. It was possibly the area not the licensing that was problematic.

A minority of landlords interviewed let property in areas where the local authority operated a licensing scheme for private landlords. Landlords were also ambivalent about licensing; supportive of plans to improve the private rented sector but unconvinced by the benefits of the scheme and resistant to some of the higher charges imposed by some authorities. Costs for licenses can be anything up to £1500 (BRE, 2010). Landlords interviewed typically incurred costs of around £500 for permits that last three to five years. Where landlords' finances were constrained these costs were seen as burdensome, but other landlords considered it a possibly unwelcome but necessary business expense. Two landlords in the North East had benefited from licensing by receiving financial support in the form of a loan for property refurbishment or discounts on council tax for vacant properties. Other landlords had not yet seen any discernible benefits.

There was no clear impact of these costs on mortgage arrears. The interviews suggested that these costs would exert further pressure on landlords *already* struggling with mortgage payments due to weak investments, but these periodic costs are unlikely to be of the magnitude or duration to trigger default.

Longer tenancies

Longer tenancies have yet to be introduced in any meaningful way and as such were not apparent in discussions of the formation of buy-to-let landlords' mortgage arrears.

However, landlords indicated how desirable longer staying tenants were but also expressed profound dissatisfaction with the formal litigation process should tenants breach the terms of the tenancy agreements and, as mentioned, relied heavily on Section 21 notices to bring tenancies to a close. Providing confidence to landlords that they would not be adversely affected by the provision of longer term tenancies in the sector would be a pre-requisite of wide take-up. This could be done by publicising the break clauses in the agreement whereby tenants and landlords have opportunities to bring the agreement to an early close in certain situations and/or by simplifying the formal litigation process and the associated costs that landlords are expected to incur to bring a case to the county court. One professional landlord was sanguine about longer tenancies and would consider their adoption after an introductory period of an assured shorthold tenancy to provide time to establish the relationship between landlord and tenant, similar to introductory or probationary tenancies among social landlords.

Conclusions

The in-depth interviews provided some additional explanations to those factors associated with mortgage payment difficulties identified in Chapters 3 and 4. Some landlords struggle with mortgage payments but avoided arrears as they occasionally or routinely subsidised their letting business finances from their own income, or borrowed from family or commercially to avoid mortgage debt. The factors highlighted in the quantitative analysis included housing benefit administration, letting in the North East, letting flats, buying at the height of the housing market boom, having problems with deposit disputes, multiple loans and being a single applicant featured in the interview data. However, these issues were often indicators of other processes in the operation of the market. Firstly, there was an absence of rigor in some landlords and some lenders' appraisal of the sustainability of the purchase and business proposals at the outset, reflecting the exuberance in the market prior to the financial crisis. Secondly, the limited experience of some landlords in property management especially in the early years. These factors left many landlords exposed in weaker rental and housing markets where negative equity prevented any curtailment of the weak or failed investment. Furthermore, landlords' failure to ring-fence their letting activity finances from their personal finances meant that triggers of mortgage debt in the residential market - job loss, failure of self-employment, relationship breakdown and ill-health - also contributed to buy-to-let mortgage default. Policy changes, notably to housing benefit, also contribute further risk.

Astute landlords skilfully appraised the market, undertook extensive financial forecasting and managed their portfolio and exposure to new risks as they arose, and effectively managed the tenancies. They have been able to sustain successful letting activities in even the most challenging markets. Other landlords with less experience of property management or who had made mistakes with their initial purchase were left vulnerable to market changes in less buoyant markets. Stronger rental and housing markets were more forgiving to novice landlords as tenant demand was strong and equity meant landlords had exit options available if they could no longer sustain the investment.

6: Summary, discussion and conclusions

Summary

The turn towards buy-to-let reflects the belief that property outperforms other asset classes, and offers people greater control than other investments. The interest in the sector from private sideline investors also signals the drive towards self-provision or asset-based welfare, rather than a confidence in the state and traditional forms of pension products. From these beginnings a number of professional landlords have emerged. As a form of do-it-yourself investment it is a business proposition demanding specific skills, more typically outsourced to fund managers and/or other intermediaries. Fluctuations may occur in any market, even for the most skilled of operators, but there is most often regulation and/or the notion of 'caveat emptor', or buyer beware, to mitigate excessive risks and remind buyers to exercise due diligence. In another sector, the circumstances around business practices may attract limited attention. However, these property investments become a policy concern as failing or struggling buy-to-let investments can potentially undermine stability in the private rented sector and the professional management and maintenance of these homes. A crude estimation suggests that over 50,000 tenants' homes are let by landlords struggling with their finances.

The rising markets prior to the financial crisis of 2007/8 masked many weaknesses in landlords' property acquisition and business acumen, and also in lending practices, that left a minority of landlords, and lenders, exposed to the market downturn, limiting landlords' ability to develop sufficient surpluses to sustain their property or portfolio in its entirety, and curtailing exits from their investments due to negative equity. The quantitative analysis found several factors that exherted weak influences over the odds of landlords accruing mortgage arrears on their buy-to-let loans, but offered only limited or partial explanations of arrears amongst the variables available. These factors included letting in the North East, problems with housing benefit administration, tenant damage, being a single applicant for a loan, buying between 2006 and 2008, buying a flat, having multiple loans, deposit disputes, finding reliable builders, negative equity and current high loan-to-values. In the context of the in-depth interview data, these factors are indicators of both the exuberance of the market, specifically at its peak, and of the difficult market circumstances in some locations, combined with a perception that processes associated with housing benefit serve landlords (and tenants) poorly. The narratives of personal financial problems quite separate from their letting activities offered by several landlords also explains some of the unobserved variation in the reports of mortgage cost problems and/or loan accounts in arrears.

Taken as a whole the findings from the survey and data analysis and the in-depth interviews reveal that landlords' letting activities, and consequently their mortgages, are threatened by: business risks, how they appraise the market prior to acquisition or operate their landlord business; and market risks, how tenant demand and rents may shift, and how house price volatility may undermine exit strategies; events in landlords' wider business or private lives, that divert rental income from the buy-to-let mortgage to their personal finances; and by policy, in respect of housing benefit, that demand greater proficiency in landlords' letting skills, or changes in the mortgage market that can exert pressures on landlords' finances. Lenders are also culpable in the formation of mortgage arrears as they also made weak investment decisions during the housing market boom.

Discussion

In terms of housing policy, the concerns around buy-to-let and the private rented sector relate to the provision of secure, stable, decent and well-managed rented homes that can accommodate a range of households. These ambitions can be jeopardised by poorly performing property investments, leading to arrears and possessions and/or potentially increased landlord, property and tenant churn in the market. There are three strands to thinking through the implications of the findings: firstly, what the findings currently mean for the sector; secondly, how if buy-to-let mortgage arrears are considered unwelcome in respect of the wider market that they can be minimised; and thirdly, what impact any corresponding actions may have on the private rented sector. There are competing pressures here which are likely to entail political resolutions.

The evidence suggests that approximately 50,000 of the UK's tenant households reside in homes based on their landlords' precarious financial foundations. This is at the margins of the market and represents a small minority of landlords and homes, although it is likely that financial instability goes beyond the reported arrears and possessions figures. There are potential implications here for the wider housing system and for any safe, secure, stable and sustainable private rented sector in particular. A landlord struggling financially to make individual properties 'stack up' undermines their ability to fulfil their landlord obligations by undertaking repairs and improvements, and there was some evidence to support this. A landlords' ability to sustain the properties through any forthcoming interest rate rises, may also mean investments intended to be long-term and stable are brought to an early close. Moreover, a growth in property values could also produce greater churn in the sector as landlords with difficult investments exit, and possibly others enter on the back of capital gains. Some landlords with sound finances may also wish to cash in on a rising mark*et al*though struggling landlords indicated that they would be compelled to do so to stem further losses. These issues not only contribute to the volatility in the wider housing market but may also undermine attempts to provide stable longer term renting. However, financially insecure lettings may represent the 'long tail' and fall out from the spirited housing market prior to the financial crisis, and the consequences of any forthcoming market changes, are dependent on the sequence of events relating to how a rising economy, rising wages, growth in rental income and property values plays out regionally. It is therefore unclear what the impact of the market moving may be or what an immediate policy response could contain. There are issues for lenders, regulators and policymakers that would have the potential to limit further volatility and default in the sector.

The impacts of landlords' financial instability in the future will also be a function of lenders' attitudes to the sector. Currently it is clear that post financial crisis loans are subject to a much lower level of default. As part of securing a secure and stable private rented sector minimising the incidence of buy-to-let mortgage arrears and ensuring landlords have the capacity to overcome shocks to their business is desirable. While some lenders may feel confident that they could recoup any losses in a more buoyant market should loans default, the wider role of buy-to-let on the housing system should also be considered. If long-term sustainable and stable investments serve the private rented sector well, then lenders and policymakers may wish to reflect on how they can ensure that buy-to-let is founded on or makes a greater contribution to the delivery of these wider ambitions. Lenders have substantial leverage in contributing to sustainable and stable investments by ensuring that landlord business proposals are sound and that landlords have sufficient appreciation of the market into which they are entering and are equipped, in terms of skills and financial resources, to handle any shocks that may arise. It is doubtful whether current lending criteria adequately reflect these ambitions. For example, requiring a minimum income of £25,000 or that people have at least been homeowners for one year are arguably poor proxies for having the resources and skills to run a property business, albeit possibly a modest one.

Lenders have adopted a cautious approach to the market following the financial crisis. There is, however, no mechanism currently in place to prevent the market returning to a more liberal and potentially damaging environment in the future. Indeed unregulated residential lending became more cautious following the 1990s housing market downturn but the pain of lenders' losses was soon forgotten once the markets began to rise during the 2000s. At the time of writing, there are signs that markets are rising again in some locations, and although not available from the lenders interviewed, there are some 85 per cent loan-to-value products with lower rental cover and new equity finance products becoming available to landlords, products that circumvent the more stringent lending criteria currently on offer across the mainstream market. There is also a re-emergence of property clubs operating in the sector. In this context, it is plausible that a greater appetite for risk may become apparent in the industry in the near future with a potential to revisit some of the previous errors.

The industry and policymakers may wish to consider how the UK regulatory framework can accommodate the needs of the wider housing market, as well as reconcile disparities with EU regulation, in the forthcoming industry voluntary code of conduct for buy-to-let loans. Moreover, not all landlords could be characterised as professional business investors, many interviewed were more akin to retail consumers. It may be undesirable to exclude such investors from buy-to-let if they can demonstrate that they will adopt the necessary market and business skills to sustain the property, not least as many of the professional landlords began their letting activities in this manner. However, there is a tension between lenders chasing conservative lending and small investors on the one hand, and the absence of regulation as buy-to-let founded as a commercial proposition on the other. Moreover, in the context of rising markets the value of the Mortgage Market Review in providing a sensible lending environment and limiting lenders' contribution to housing market volatility is also undermined if one market segment has less constrained access to mortgage finance, and could become potentially more attractive to lenders.

There are also implications for the wider market in pursuing "vanilla" lending; in that such lending may accommodate only "vanilla" tenants. Mainstream risk averse lending may preclude landlords accepting any arrangements seen as unusual or niche, which may include students, tenants in receipt of housing benefit and/or local authority licensing schemes, for example. This would contribute to a shift in the private rented sector away from that which policy is pursuing, in that the private rented sector should be a secure place for a wider range of households than has previously been the case.

What may be termed 'tick box' lending criteria may serve high volume lending processes excellently, but may be too crude a method of appraising loan applications if landlord proficiency is to be identified and wider ambitions of supporting a safe and stable private renting is desirable. Moves to restrict loans to housing benefit tenants are undesirable in policy terms, although there was some evidence that the housing benefit administration is problematic for landlords' finances. What appears to be critical, however, is the landlords' confidence in being able to navigate this submarket. It is, therefore, the landlords' knowledge and skills that should be subject to appraisal rather than simple but exclusionary clauses in loan agreements. Moving away from the processes associated with volume lending would incur costs that may limit investment in the sector, however, but these issues are raised to prompt discussion about how lenders can better serve wider policy ambitions.

For tenants in receipt of housing benefit the payment uncertainties and less generous allowances in the context of housing under-supply in some markets means these tenants find it hard to compete if alternative tenants with less fragile incomes are available. Landlords operating modest or small letting businesses may understandably be wary, although many make this market work well for them. Lifting lending restrictions on landlords letting to some niche tenants may support an inclusive private rented sector but there are indications that public policy could also do more to bolster the market position of these tenant groups by reviewing the administration, levels of housing benefit and permitting landlords to be paid directly if the tenants agree.

A stable and sustainable private rented sector would be a supportive environment for the introduction of longer term tenancies, but business models made on short term capital gains and/or instability in landlords' finances may undermine these ambitions. Landlords welcomed longer lets but most had little confidence in formal litigation procedures to remedy tenancy breaches, so it is uncertain how this sentiment may translate into the adoption of formal longer tenancies. Although professional landlords indicated that longer term tenancies may be acceptable, after an introductory period on an assured shorthold tenancy, the risk to some other landlords that they would endure a protracted period of litigation to bring a tenancy to an end may act as a deterrent. On the evidence generated from this study, work on simplifying and streamlining the litigation process and reducing the costs associated with cases may add greater weight to arguments for longer tenancies.

Conclusion

The evidence contained in this report depicts a complex set of factors that may influence the accrual of mortgage arrears on landlords' buy-to-let loans: different market conditions, the borrowers' business acumen, their personal circumstances and policy initiatives. These factors will present in various configurations and induce financial stress for landlords. This becomes a policy concern as increasingly larger proportions of households have their home in the private rented sector and want to stay for the longer term. It is, therefore, incumbent on lenders, landlords and policymakers to foster and environment where a sound stable financial footing underpins these tenancies. Threats exist from liberal lending that failed to ensure that all landlords had a sound business case for their letting activities; from landlords who under appreciated the markets they entered and the skills required to operate as a landlord; and from policymakers that have undermined some landlords' confidence in housing allowances. While the vast majority of landlords do not accrue mortgage arrears on their buy-to-let loans, a minority struggle to meet the payments. The potential consequences include landlords finding it difficult to fulfil their landlord obligations and increasing churn in properties, landlords and tenancies within the sector, and, therefore, undermining the policy ambition of stable secure renting.

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Appendix 1: Research Methods

English Housing Survey Private Landlords Survey

The English Housing Survey is a continuous survey conducted in England on behalf of the Department for Communities and Local Government. It comprises a household survey and a physical inspection of the property. Periodically, a Landlord's Survey is also undertaken. This supplementary survey identifies landlords via a sample of private tenants selected from the main survey. The landlord, or the agent acting on their behalf, is then asked to complete the questionnaire. There are approximately 1000 landlord responses in the 2010 EHS-PLS dataset, collected during 2009-2010. The EHS-PLS provides weighted datasets by dwellings or by landlord, depending on the context in which they are being used. The analysis presented here has adopted the 'landlord weights' data to analyse the characteristics of landlords and lettings where the landlord reports problems with mortgage costs. The survey does not ask landlords if they have arrears on their mortgage, but whether they have small or serious problems with mortgage costs and these variables are used in this study as an indicator of payment stress. It is acknowledged that not all landlords who report problems with costs will fall into arrears.

These data represent a robust and comprehensive reflection of tenant and landlord circumstances and provide an insight into the issues associated with landlords' mortgage problems. The EHS-PLS includes the early implementation of the 2008 change to pay housing benefit directly to tenants rather than landlords; however, these data pre-date many current welfare reforms. Other changes have occurred since 2010, relating to the economy, cost of living and different pressures on housing markets, but nevertheless, the suite of questions included in EHS-PLS means that the dataset provides a strong starting point for this analysis.

Lender loan book data

Unlike the EHS Private Landlord Survey data, this dataset does not comprise a representative sample, but reflects lenders' entire loan book of buy-to-let mortgage loans as at September 2013. There are some 338,908 records, from 214,780 unique landlord customers. The records originate from 2001 and include all buy-to-let loans advanced since that date plus a small percentage made prior to this date. Loans made prior to 2001 are excluded. All data are anonymised and the geographical location is set at the devolved countries of the UK and Government Office English regions, so no customers were identifiable.

The dataset has 15 variables (set out below) from which other variables have been derived:

- Loan category
- Customer code
- Age of Borrower
- Joint or Single Borrowers
- Region (Customer)
- Region (Property)
- Original Advance Date
- Months in Arrears
- Initial Advance (£)
- Repayment Method
- Last Valuation (£)
- Last Valuation Date
- Type of Property
- Outstanding Debt (£)
- Possession

In comparison to the EHS-PLS 2010 the loan book data provides fewer details about tenants, market segment and landlords' characteristics or attitudes, but does include a greater depth of information about the property values, borrowing on each account and actual arrears and possessions.

Lender interviews

A total of eight in-depth qualitative interviews were undertaken with lenders active in the buy-to-let mortgage market. The lenders represent approximately 60 per cent of the buy-to-let mortgage market and included a range of specialist and general providers, those with open and closed books, and comparatively new entrants to the market. The interviews were undertaken between September and December 2013. The discussions lasted between 40 and 60 minutes and were conducted on the telephone. The vast majority were recorded and transcribed professionally, and where this was not possible interviews were either recorded and notes written up afterwards. A topic guide was used to guide the conversation which covered issues such as the strengths and weaknesses of buy-to-let market, the lending criteria for buy-to-let loans and changes over time, perceptions of the common reasons behind buy-to-let mortgage arrears and approaches to the management of buy-to-let arrears.

Landlord interviews

A total of 25 in-depth qualitative interviews were undertaken with landlords. Landlords who would speak about mortgage debt were hard to locate and after limited success with a mail-out from the lender, the landlords were recruited via a number of other means that included: on-line landlord advice forums (property118.com, landlordzone.co.uk, and propertytribes.com), moneysavingsexpert.com, and – most successfully- email invitations circulated by local authority private sector landlord forums. Table 1.1 illustrates the spread of key circumstances amongst the landlords interviewed.

Table 1.1 Profile of landlords interviewed

Region	In arrears	Struggling with payments	Not in arrears or struggling	Total
North	4	3	3	10
Midlands	2	-	-	2
South	5	2	5	12
Scotland	1	-	-	1
Total	12	5	8	25

A total of nine landlord respondents were professional full time landlords, possibly due to the style of recruitment as single property landlords are arguably less likely to be engaged with landlord advocacy websites or organisations. The proportion of professional landlords among the interviews is significantly more than the proportion among all landlords, although is fairly representative of landlords as a proportion of properties let. The number of properties held by the landlord participants ranged from 1 (n=4) to 45, and the mean average was 10 properties held. A greater proportion of single property landlords would have been desirable, but nevertheless, the interviews illustrate landlords' financial pressures and illuminate the issues raised in the quantitative data analysis.

The interviews were conducted between September and December 2013 and, as with the landlord interviews, were largely recorded and transcribed professionally. A topic guide was used to guide the discussion that included the motivations for becoming a landlord, market appraisal, obtaining mortgage credit, the management of the property or portfolios, the experiences of mortgage arrears, and the management of arrears by the landlord and lender.

Appendix 2: Landlord Topic Guide

Introduction

Restate purpose of research and confidentiality (no lenders/agents etc will know)

Check time for interview

Permission to record conversation

Brief factual details to interpret conversation

1. Location of landlords home
2. Location BTL property(ies)
3. Household income/composition/age/industry (if not professional landlord)
4. How long been a landlord?
5. How many property(ies)?
6. When purchased?
7. Type of property(ies)?
8. PRS Submarket- types of tenants?
9. Any HMOs?
10. Type of tenancies (AT, AST etc.)
11. Are the/Is the property(ies) mortgaged?
12. Does the rental income cover the mortgage/ and other costs?
13. Have you ever had arrears on the account(s)?
14. Lender
15. Have you ever remortgaged?
16. Date loan taken out?
17. Stage of action by lender? Notice, Court, awaiting possession, receiver, possession

Becoming a landlord

Motivations for being a landlord? How did you get started? What were /are your expectations of renting? Have your expectations changed since you bought? If so, why? have you had/do you hold other properties?

How did you finance the purchase of the property, savings and mortgage, remortgage home, mortgage alone etc.? What was it about the mortgage product that was attractive? Was there any criteria attached to the loan, rental income % of mortgage, who could let to, for how long etc.?

How do you manage the properties and tenancies? If you use an agent, what level of service do you receive (tenant find, full management etc.)? What has your experience of letting agents been? Or do you manage the tenancy and property yourself? Have you always done this? If changed why?

What has been your experience of setting the rent? And how has the rental income related to the mortgage payments since you took the property one?

What has been your experience of finding tenants for your property(ies)?

Have you any experience of local licensing arrangements set by the local authority? What impact has this had on your landlord activities? (ability to find tenants, rents, void periods etc.)

Have you ever approached the local authority about letting to people they nominate (Private Sector Leasing arrangements)? Did you seek permission of the lender? What was their response? What were your experiences?

What sources of information, advice and support do you draw upon to help you be a landlord?

Do you have any form of landlord insurance to cover any risks in letting the property? If so what does it cover? What made you decide to get this? Does your agent guarantee rental income at all?

Reasons behind mortgage payment difficulties

When did you first find the BTL mortgage payments difficult? (was it sudden fall into arrears, or result of long stretch of struggling to make the payments?)

What were the key reasons for payment difficulties?

a. Personal reasons (loss of earnings- ill health, redundancy, relationship breakdown etc)

b. Tenancy reasons (voids, tenant arrears, unpaid housing benefit/overpayments, repairs- (un)-expected?, tenant damage, etc.), or mixture more than one;

c. Property reasons negative equity perhaps.

If personal reasons- to what extent did you rely on earnings or savings to supplement the rental income? Has this been comfortably managed in the past? From what sources did you top up the rent to pay the mortgage? If not clear, ask what changed to make this difficult now. If loss of income, is there a prospect of new job/earnings in the short term?

If tenant reasons- Ask for further details about circumstances-

a. Why void period problematic? Were voids built into the business plan? If unexpectedly lengthy void, reasons behind this?

b. What steps were taken to check the affordability for tenant? Credit scored or housing benefit was in place at the outset of the tenancy?

a. If tenant arrears, what were the reasons for their rent arrears? loss of job, debts, failure to pay top ups, LHA stopped/ delayed

b. What actions taken to press tenant to repay / liaise with housing benefit/go to court etc.? How effective were these actions?

c. If repairs were required were they planned, expected, or result of tenant damage?

d. Have they experienced these events before? What was different to make the events problematic this time?

e. What role did the agent play, if appropriate, to resolve the matter?

If property reasons- ask about extent of negative equity, they made decisions about paying the loan, did rent ever cover mortgage?

Have the criteria attached to your buy-to-let loan affected the incidence of arrears? Would you like to let to HB tenants, have longer tenancies, etc.

Management of arrears

What has been the response of your lender to the mortgage arrears? How would you characterise this response? Good, bad, supportive, unhelpful?

Could you talk me through what happened when you first went into arrears? Who made first contact, to what end, what agreements were you able to reach if any with the lender to repay the arrears? How quickly did they move to legal action, court and possession?

If they had landlord insurance has it been effective in minimising difficulties in the circumstances you describe?

Impact of arrears

What has been the impact, if any, of having arrears on the rented property for you and your household?

If appropriate, was the property tenanted when possession orders obtained? At what point did you or the lender involve the tenants in the process, if at all? Was a receiver appointed do you know? Do you know what happened to the tenant?

Remedies

Are there any steps landlords, lenders, agents, policymakers should make to minimise risks of landlord mortgage arrears?

Closing remarks

Is there anything else you think is important that the research team understands?

Can we get back to you if quant analysis reveals anything startling we've not discussed?

Inform when we report and will receive a summary.

THANK YOU

Appendix 3: Lender Topic Guide

Introduction

Restate purpose of research and confidentiality

Check time for interview

Permission to record conversation

Briefly general BTL market

Overall views of general BTL market's strengths and weaknesses (role in market, meeting need, lending, regulation etc.)

Individual organisation BTL activities

Their own organisations involvement in the market, when entered, share of market,

Lending criteria types of tenants, length of tenancies, rental income % of repayment, LTV, changes over time (current criteria may be online). Why have you stipulated this criterion? What assumptions/ evidence are they based on?

Types of landlords, changes through time, single or multiple, age, background, motivations, accidental etc.

Types of properties involved –new build or second hand market, ex LA, changes through time, types, size, locations etc.

Incidence of arrears

Organisation's experience of arrears, changes over time?

Are there any patterns to the type of landlord borrowers experiencing arrears on their accounts (type of tenants, properties, year of purchase, LTV etc.)

What reasons do landlords give for accruing arrears (lost earnings, unemployment, tenant arrears, voids, repairs, over-indebted etc.) are any specific reasons associated with particular landlords, locations etc.

Management of arrears

Lenders

Can you outline your approach to landlord arrears management processes? What tools do you have to intervene or provide support?

If you have residential loans as well, how does this differ to residential loan arrears management? What are you able to do with commercial loans that you cannot do with residential regulated ones? Or vice versa?

Have there been any changes to how you approach the BTL loan arrears over time? If so what prompted this? And with what effect?

To what extent do landlords have secondary / multiple charges on the properties?

Landlords

What are the responses from landlords to their arrears? What actions to remedy the situation do they report? Selling property/repayment schedule/request forbearance options/ re-let etc. What types of support do landlords ask from you? Are there requests that you can't meet? i.e. extended forbearance etc.

What impact does negative equity have on landlords' arrears or management of their account? Do you detect any strategic default? If so, any particular locations, types of properties, types of landlords etc.

What role if any do advice agencies or lawyers play in the management of BTL arrears too?

Are the rising level of BTL repossessions reflected in your own organisation, if so why? What would you say is driving the increasing repossessions in BTL sector? What are the prospects of BTL arrears in short-medium term?

What would be the impact of rising interest rates in this area?

As a consequence of experience with arrears have you ever amended any policies and if so, how?

Impact of BTL arrears on tenants

What impact did the legal changes to protect tenants in the repossession process in 2010 make to your management?

How do you identify cases when it's appropriate to appoint a receiver to collect the rent? How often does this occur and have there been changes over time?

In what circumstances do you contact the tenant directly? How often does this occur and have there been changes over time?

Closing remarks

Is there anything else you think is important that the research team understands?

Can we get back to you if quant analysis reveals anything startling we've not discussed?

Inform when we report and will receive a summary.

THANK YOU

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