



Association of Mortgage Intermediaries response to HM Treasury's consultation paper on Mortgage Regulation

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI). AMI is the trade association representing over 75% of UK mortgage intermediaries.

Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product to meet the individual consumer's mortgage requirements. Our members also provide access to associated protection products.

Our members are authorised by the Financial Services Authority (FSA) to carry out mortgage and insurance mediation activities. Firms range from sole traders through to national firms and networks with thousands of advisers.

AMI welcomes the opportunity to respond to HM Treasury's consultation paper on Mortgage Regulation.

This paper only considers the issues set out in chapter three, regarding the regulation of buy-to-let mortgages, which is of particular interest to AMI members.

Regulation of buy-to-let mortgages

Introduction

We consider that any proposal to regulate buy-to-let mortgages requires careful consideration. An appropriate balance will need to be reached between protecting vulnerable consumers and tenants, whilst not restricting the operations of commercial businesses, which do not necessitate an enhanced level of protection.

The proposal has placed a separation between individual landlords and commercial businesses. Whilst individual landlords will come under the regime, limited companies and business-to-business lending will be excluded from the proposed regulatory scope. However, our key concern is whether the suggested divide will achieve the objectives outlined in the paper.

We feel that many of the issues identified in the market failure section resulted from an over heated property market. The buy-to-let market has already acted to reduce risk by significantly limiting loan-to-values, in particular for new build property. This has resulted in a reduction to the levels of mortgage finance available. The buy-to-let market has demonstrated a capacity to self-regulate with regard to now obvious over-exposure and risk.

Proposal

We believe that the objectives of regulating the buy-to-let mortgage industry should be the provision of protection for tenants, improving confidence in the private rented sector and strengthening the resilience of the market.

AMI would raise concerns whether these objectives could be achieved by FSA regulation of buy-to-let mortgages. We do not believe that FSA regulation of buy-to-let lending is the most appropriate tool to prevent the identified market failure issues from taking place.

Protection of tenants

The paper raises concerns about the consequence for tenants when the properties they rent are repossessed. These are very real concerns and tenants are affected by circumstances that are beyond their control. Defaults on rental properties can result in the repossession of other properties within a portfolio. The tenants renting these properties may not have missed a rental payment themselves. Those tenants that have had their rental property repossessed are protected by their Assured Shorthold Tenancy agreements (AST).

If the current protection for tenants in these scenarios is considered to be insufficient, applying regulation to buy-to-let mortgages would seem unlikely to increase their security. If tenant protection is to be reviewed then consideration should be given to the levels of tenant protection that are offered in other EU member states.

To address the issue of tenants' protection it would seem more appropriate to review the rights of tenants under their tenancy agreements, rather than the regulation of the finance used by their landlord to fund the purchase of their rental property.

Scope of regulation

There has been little evidence to show that the issues identified within the market were solely as a result of the borrowing decision. It would seem unlikely that an alternative 'better' product would have resulted in a reduction in the issues

identified within the market failure analysis. It is unclear what impact regulation would have had on the market if had it previously been in place. Such a study may be required before it can be established whether regulation of the buy-to-let market would be effective at achieving the proposed objectives.

The decision to invest in property is multifaceted and the method of financing a purchase is only one of a number of factors that should be considered. Finance is not always obtained on a property by property basis. Many investors will be borrowing against their portfolio of properties. We would caution against the scope of regulation being extended to include these sophisticated landlords. We do not believe that this type of landlord would benefit from FSA regulation.

The scope of the proposed FSA remit does not make a distinction between the varying funding options used. Some properties will be purchased using pre-designed 'packaged' buy-to-let products, similar to residential mortgages. These are generally used for the purchase of an individual property by an individual. Other property purchases will be funded through case by case products, designed by the lender, for the purchase of both large commercial properties and individual residential properties. These are generally termed as 'commercial mortgages'. Whilst these 'commercial mortgages' are used to finance substantial purchases, these can still technically be taken out by sole traders or unincorporated partnerships. The proposals would seem to place these commercial mortgages within FSA's remit, however, this would seem inappropriate given the levels of sophistication used to undertake a lending assessment on such borrowing.

There are fundamental differences between buy-to-let mortgages and residential mortgages. If FSA's remit is extended to include buy-to-let mortgages it may not be appropriate to include buy-to-let mortgage regulation directly within FSA's MCOB rules. Given the work that FSA is currently undertaking as part of its Mortgage Market Review, where prescriptive affordability assessment rules are being proposed, it would be difficult to read-across these directly to the buy-to-let finance model. We would be concerned that the application of such proposals within the buy-to-let market could substantially reduce levels of activity. What could be more appropriate would be to create a new subsection of MCOB, similar to that used in the regulation of equity release and sale and rent back. This would allow appropriate rules, which take account of the distinctive characteristics of buy-to-let finance.

If FSA's scope is extended, any proposed regulation will need to take account of the current market conditions. Some landlords will already hold buy-to-let mortgages; if regulation significantly changes the lending parameters of these products then these landlords may in effect become 'mortgage prisoners'. This could leave them unable to refinance and could result in difficulty for these individuals, which may serve to increase levels of arrears and repossession, the very opposite of what regulation is intending to achieve.

Limited companies

It would seem unlikely that the regulation of buy-to-let mortgages would lead to a landlord choosing to set up a limited company rather than creating a property portfolio on a sole trader basis, unless they saw it as a route to obtaining un-regulated buy-to-let mortgage products.

The unintended consequence of these proposed changes could be to substantially reduce activity in the buy-to-let market. Potential landlords could be driven away from the market due to the advent of FSA regulation and a desire not to set up a limited company which would be required to operate outside of FSA's scope.

This comes at a time when not only is buy-to-let mortgage finance hard to obtain but that which is available is costly in comparison to recent years. Furthermore, the Government sees buy-to-let finance as essential to increasing the levels of private rental sector properties and financing the construction of new rental properties. Any proposal that restricts buy-to-let activity could run contrary to the proposals made in HM Treasury's consultation paper on investment in the UK private rented sector.

Landlords will also need to consider whether there are restrictions in the products offered by lenders. Most lenders' prudential requirements result in higher capital reserves, and therefore costs, to lend to limited companies and some lenders will require a personal guarantee or a relinquishing of a directors limited liability before they are prepared to lend.

We are concerned that this may impose an unintended restraint on the market, at a time when the demand for private rental sector properties continues to grow.

Commercial businesses

There is a view that the decision to become a landlord is a commercial decision and it is true that a commercial relationship will exist between landlord and tenant once the rental contract is agreed. Furthermore, these properties will present an ongoing commitment to the landlord, not just in maintaining the assets, but also in the ongoing sourcing of new tenants to ensure rental returns are maintained. Whether this is done by the individual themselves or outsourced to an agent, the landlord will still have to make a commercial decision as to what option is most appropriate for their circumstances.

A prime objective of FSA is to "help retail consumers achieve a fair deal". It is questionable whether the decision to become a landlord, using a buy-to-let mortgage to set up that business by purchasing properties, should constitute that

individual being considered to be a retail consumer. It could be argued that all landlords are in fact operating on a commercial basis.

If the proposed regulation of buy-to-let mortgages does occur we would want to ensure commercial businesses are exempt from such regulation. Regulation should not restrict the buy-to-let market further. The market is already considerably constrained by a severe lack of funding as a result of the banking crisis. The proposals to exclude limited companies and business-to-business lending are essential to ensuring that experienced commercial property investors are excluded from FSA regulation.

Considering the business status of the landlord alone is unlikely to provide the correct balance as to what should and should not be included within the remit of FSA regulation.

Arrears and Repossessions

The method by which a buy-to-let property purchase has been funded will only form part of the reasons for arrears and repossessions occurring. Life events, such as redundancy and illness, will also have an important impact, not only for landlords, but also for tenants within the rental properties.

Regulation should not automatically be considered to be the most appropriate solution if the numbers of arrears and repossessions have increased. Before FSA regulation of the buy-to-let mortgage industry is considered further, HM Treasury should review whether the proposed extension of FSA's remit would have resulted in a reduction in the numbers of arrears and repossessions that have taken place within the buy-to-let market since the banking crisis started.

The paper is concerned that payment difficulties could not only affect a landlord's property portfolio but also their residential mortgage too. There is concern that a landlord who is struggling with one or two rental properties, which have defaulted within their portfolio, can then struggle to meet payments on their own residential mortgages. In this event landlords are likely to prioritise their residential mortgage, to the detriment of their buy-to-let mortgage accounts.

It is certainly the case that, whilst some landlords may only hold one rented property, many landlords will have a portfolio of properties. Rental arrears, voids and defaults, on a minority of properties within the portfolio, could effect the overall integrity of the whole portfolio, which could subsequently lead to the affordability of the landlords own residential mortgage coming under pressure. Whilst such circumstances could exist, this issue is likely to be the same for any sole trader who operates a commercial venture that has run into financial trouble or fails.

Fraud

There are clearly examples of some fraud within the buy-to-let mortgage industry and AMI would welcome any action that would result in a reduction in fraudulent activity. However, some of the fraud that takes place within the mortgage market is reliant on solicitor, estate agent and valuers' involvement. It can not be created by broker involvement alone. These industries will also need to be addressed if the levels of reported fraud are to be reduced.

Regulation of buy-to-let mortgages – consultation questions

Question 11: Do you agree with the analysis of the buy-to-let mortgage market and the risks of market failure?

In general, yes.

Question 12: Do you agree that FSA regulation will mitigate the risk of market failure in the buy-to-let mortgage market?

Until FSA provide details of its proposals for regulation, it will be difficult to make such conclusions.

The reasons for market failure occurring are not solely down to the method of funding that has been selected. It is difficult to see how regulating buy-to-let lending would, in itself, prevent further market failure from occurring. Life events such as redundancy and illness will always happen in UK society, these will have an impact not only on mortgage arrears and repossession figures but also on rental payment defaults.

Those tenants that are affected by their rental property being repossessed are already protected by their Assured Shorthold Tenancy agreement (AST). If the current protection for tenants is not thought to be sufficient applying regulation to buy-to-let mortgages would seem unlikely to increase tenants' security and protection. It might be better to review the tenants' rights under their tenancy agreements.

It is proposed that FSA's regime will only cover lending to individual landlords, including businesses constituted as sole traders or unincorporated partnerships, but not to businesses established as limited companies. For FSA regulation to mitigate the risk of market failure in the buy-to-let mortgage market it will need to demonstrate that it will reduce the levels of arrears and repossessions. To do this it may need to first establish if there is a higher quantity of arrears and repossessions coming from individual landlords as opposed to limited companies.

Question 13: Do you agree with the costs and benefits of the options under consideration in relation to buy-to-let mortgages, as set out in the Impact Assessment?

Yes.

Question 14: Do you agree that FSA regulation of buy-to-let mortgages should be limited to lending to individuals and trustees?

We believe that any proposal to regulate buy-to-let mortgages needs to carefully consider the balance between protecting consumers and not restricting commercial business. An artificial divide will need to be put in place to draw a distinction between consumers and commercial businesses operating within the buy-to-let market.

We are concerned that there is a lack of definition about the type of funding models that are used to finance the purchase of properties to rent or that are already tenanted. Whilst some landlords may buy properties on an individual basis, with security being held against each specific property, others are purchasing properties using funding secured against an overall book of properties. Little consideration appears to have been given to this type of funding. It is unclear how this would fit within the proposed scope of FSA regulation.

Question 15: Do you agree that the proposed new condition relating to the use of the property as a dwelling would include buy-to-let mortgages and continue to include residential mortgages?

This would appear to be a necessary requirement if buy-to-let mortgages are to come within the scope of the FSA.

Question 16: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to buy-to-let mortgages?

Consideration will need to be given to the cumulative effect that the regulation of buy-to-let mortgages, combined with FSA's Mortgage Market Review proposals, could have on the buy-to-let industry. If some of FSA's prescriptive affordability assessment proposals are introduced, it could limit the ability of individuals to transact buy-to-let mortgages. If the use of existing equity withdrawal is limited, it may restrict the development of small private buy-to-let portfolios.

Given the differences between buy-to-let mortgages and residential mortgages, it may not be appropriate to include buy-to-let mortgage regulation directly within FSA's MCOB rules. What could be more appropriate is to create a new subsection of MCOB, similar to that used in the regulation of equity release and sale and rent back.

Question 17: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for buy-to-let mortgages?

We would not want to see the extension of FSA regulation covering buy-to-let mortgages damaging the industry, and in particular, the wider corporate market. Therefore, exemptions and exclusions will need to be applied. The divide between individuals and limited companies should be given further consideration.

AMI

15 February 2010