

Renting in the recovery

How many private renters could get caught up in repossessions as interest rates rise?

Pippa Lane

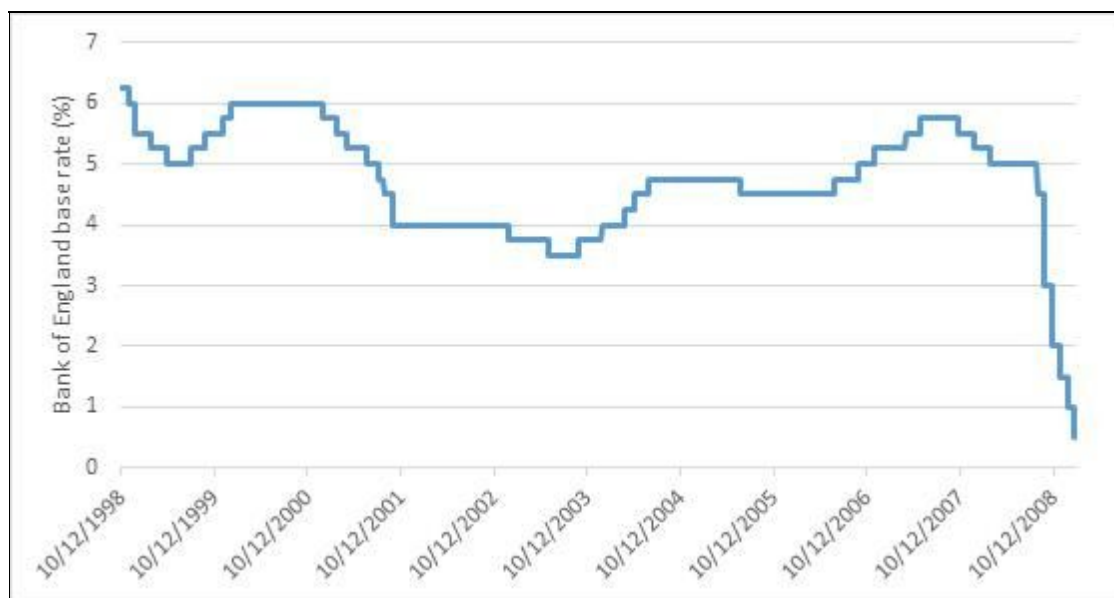


Interest rates have been historically low since 2008 and, while there remains considerable uncertainty over the pace of interest rate rises, analysts still expect rates to return to more normal levels in coming years. However fast this process of normalisation happens, there will be widespread impacts across the economy. Particular concern has been raised about the likely impact of rising rates on repossessions among the owner-occupier population, many of whom are highly leveraged. This short briefing note considers a related but far less widely-discussed question: how many private renters could be caught up in landlord repossessions, and what rights do these renters have?

Context

The Bank of England base rate currently stands at an historically low 0.5 per cent and many expect that this figure will begin to rise during the course of 2015 or early 2016. From Bank of England independence in 1998 to 2008, the base rate averaged 5.05 per cent. Following economic developments since 2008, however, markets now expect a long-run nominal rate much lower than this, at around 3 per cent, as the economy stabilises in future years. This position was publicly endorsed by the Bank's chief economist, Andy Haldane, in a speech in Bristol in November 2014. More recently, the Governor of the Bank of England, Mark Carney, has stated that it is likely that interest rates will begin to rise in late 2015.

Figure 1: Bank of England base rates (%)



Source: Bank of England

When it comes to the impacts of rising rates, some consideration has been given to the effects on owner-occupiers with mortgages; a number of organisations have examined the likely effect that rising rates could have on households' repayments, and therefore on the financial pressures households are under. Less attention has been given to the related question of what impact rising rates could have on tenants caught up in the middle of a landlord's repossession. This short note

considers this question, looking at the rights tenants have in such cases; the number of tenants who could be affected; and what the cases we deal with at Citizens Advice tell us about gaps in legal protections.

Tenant rights in cases of landlord repossession

We start by considering what legal rights tenants have when their landlord is repossessed. In standard cases in which a tenant is evicted outside of a repossession the main determinant of tenants' rights is the contract that governs their tenancy. Most tenants in the private rented sector hold assured shorthold tenancies which typically consist of a fixed period followed by a rolling notice period. If a landlord chooses to evict a tenant when the fixed period is over, they can invoke Section 21 of the 1988 Housing Act. Under these powers, the landlord can request that the tenant leaves in two months, without being required to give a reason. If the tenant has not left by the specified time, the landlord can then go to court to obtain a possession order for a specified date, which can then be enforced by bailiffs.

Section 21 notices can be of relevance in cases of repossession if a landlord decides to evict the tenant when they get into financial difficulties. For example, a landlord might try to find other tenants in order increase rents to help them meet their mortgage repayments. However, in many cases in which a property is mortgaged and the landlord is defaulting on payments to the lender, the landlord wants to avoid the loss of rental income that would arise from changing tenants. In these cases, it is common for the landlord to continue the tenancy, meaning the tenant becomes caught up in the repossession process itself.

When a tenant continues to live in a property while their landlord undergoes a repossession, the circumstances of the landlord's mortgage become a key factor in deciding the tenant's legal position. Specifically, the tenant's position depends on whether or not the lender (i.e. the bank that lent the mortgage) has authorised the landlord to rent out the property. There are two possible answers to this question:

If the landlord took out a buy-to-let mortgage or if the lender has permitted the tenancy or recognised the tenancy in another way, **the tenant retains standard levels of protection**. In technical terms, in these cases, the law sees the tenancy as 'binding' on the lender. In such cases, the lender typically takes over the tenancy from the landlord on repossessing the property and the tenant then retains their same Section 21 rights to two months' notice of eviction. A buy-to-let mortgage repossession may not always lead to the tenant being evicted, for example if the lender decides to continue to receive rent in lieu of the original landlord. The property then may be sold with a sitting tenant. In many of these cases little would change for the tenant; their rent would now simply be paid to the bank, and later to a new landlord.

If the landlord has *not* been authorised to rent the property, however, for example if they have let the property part-way through a mortgage term without seeking authorisation, **the tenant is in a more complex and vulnerable position**. In these cases, the law sees the tenancy as not binding on the lender. In practical terms, this means the lender (for example, the bank that is repossessing the property) can apply through the courts for a possession order to evict the tenant. This can then be enforced with bailiff action.

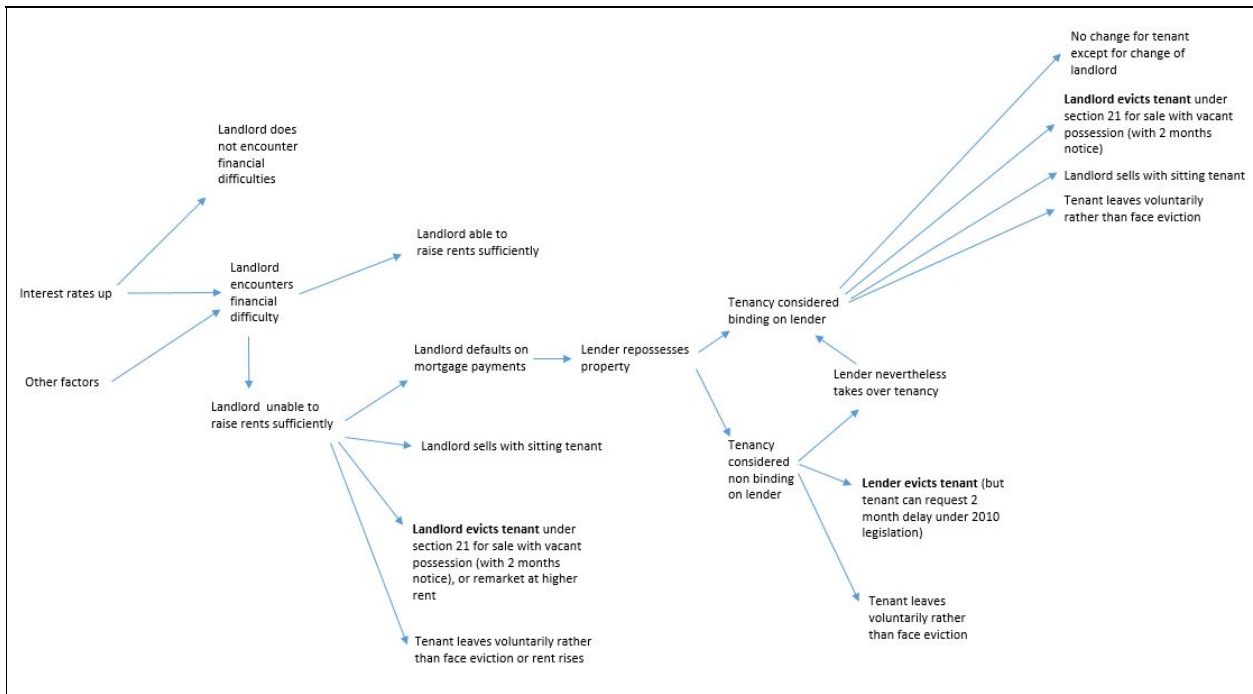
For some time there has been concern about tenants in this latter position. At Citizens Advice we have many years seen cases of tenants only hearing about the repossession of their landlord's property - and their home - when an eviction notice was delivered to their landlord, or when bailiffs arrived on the doorstep to carry out the eviction. Our clients, some with young families, often had little time to organise alternative accommodation. Some found themselves at risk of homelessness as a result of circumstances entirely beyond their control.

As a result of longstanding concerns about tenants in this position, on 1 October 2010, the Mortgage Repossessions (Protection of Tenants etc.) Act 2010 came into force. The 2010 Act strengthened protections for 'unauthorised' tenants, requiring that "the lender... now issue a notice (Notice of Eviction of Possession Order) to all properties where it plans to enforce a possession order via a warrant". This means a tenant will receive a notice telling them their landlord is being repossessed. If the repossession is planned within two months, the notice also gives tenants the right to request an extension of up to two months in their tenancy from the mortgage lender, giving more time to find alternative accommodation. We supported this change to the law, which, at least in theory, affords tenants' greater protections.

Estimating numbers of private tenants affected

Having set out the state of tenants' legal protections, we now look at the potential scale of the problem. How many private renters could be caught up in repossessions as interest rates rise? This is a difficult question to answer because there are complicated feedthrough mechanisms from rising interest rates, to rising financial pressure on landlords, to a tenant still being in the property as the repossessions process runs through. In this note we focus on one aspect of this problem, looking at likely trends in overall authorised (buy-to-let) mortgage repossessions and unauthorised repossessions (a subset of overall residential mortgage repossessions). Figure 2 summarises the links from rising interest rates to tenant evictions. In this note we do not consider the impact on tenants of rising rents, another way in which rising rates could impact on private renters.

Figure 2: Logic chain of rising interest rates and tenant evictions



Data from the Council of Mortgage Lenders (CML) allows us to explore the historic relationship between Buy-to-Let and owner-occupier repossession rates. We can then use published estimates of future rises in household repossession rates to estimate future rises in buy-to-let repossessions, and so the potential number of ‘authorised tenants’ who could face eviction be caught up in their landlord’s eviction.

The number of owner-occupier repossessions has fallen in recent years, as might be expected when interest rates are historically low. Low repossession rates are also believed to be linked to the more lenient forbearance policies that have characterised the owner-occupier mortgage market since the financial crisis. There are a number of different estimates of how rising interests could feed through into financial pressures in 2015 and beyond:

- The Resolution Foundation has estimated that a rise in the base rate to 3 per cent by 2018 could see the number of households spending more than a third of their household income on mortgage payments rising to one-in-four of those with a mortgage, or 2.3m people, up from 1.1m now. This would increase the financial pressure on households, likely feeding through into rising numbers of owner-occupier repossessions, particularly where households also have other debts.
- Research for the Bank of England, who define financial distress at the slightly higher rate of mortgage payments making up 40 per cent of household income, suggest that a two point rise in base rates, if undertaken in one go and accompanied by a 10 per cent rise in household incomes commensurate with the economic cycle, would increase the proportion of households in financial distress from 1.3 to 1.8 per cent, with households responding by

reducing spending, causing aggregate spending to fall by 1 per cent. If incomes do not rise then the proportion of households in distress would be higher, but still lower than recent peaks. Again this would be expected to increase the number of repossessions but perhaps not to a large extent given the ability of households to reduce spending as an alternative strategy to missing mortgage payments.

- In their market summary published in July 2015, the CML itself estimated that the total repossessions figure will fall further from 21,000 in 2014 to 16,000 in 2015 as interest rates remain low, before starting to rise to 16,500 in 2016 as interest rates eventually start to climb upwards.

This CML estimate provides the most direct estimate of the number of total repossessions. Using a ratio of 30 per cent between buy-to-let and owner-occupier mortgages, in line with that which held in 2014, would then produce an estimate of around 4,800 buy-to-let mortgage repossessions in 2015, a slight fall from 2014. Presuming that when the interest rate rises do come, they will have a slightly greater effect on buy to let landlords than on owner occupiers due to the effects of rising household incomes and well-established forbearance procedures, buy to let repossessions might then rise to around 5,280 in 2016 and, extrapolating forwards, perhaps around 5,760 in 2017. Looking further forwards to when interest rates peak, if total repossessions then rose to around 30,000, similar to the level at the end of 2012, then the same ratio would give an annual estimate in that year of 9,600 buy-to-let repossessions, or an increase of around 4,800 from the level expected this year.

These figures give a sense of the potential number of 'authorised' tenants caught up in a landlord's repossession. This does not take into account landlords who do not have permission from their lender to rent out their property. By definition, it is hard to estimate the number of these 'unauthorised' tenancies. However, the impact assessment for the Mortgage Repossessions (Protection of tenants etc.) Act, estimated that between 500 and 2,000 unauthorised tenants face eviction each year as a result of repossession.

Given the large range of this estimate and the falling number of residential mortgage repossessions, it is likely that 500 to 2,000 remains a reasonable estimate for the number of unauthorised tenants evicted due to a landlord repossession. If these evictions increased at the same rate as authorised tenant evictions, we would see these rising to 600 to 2,400 by 2017, bringing the total number of tenant evictions due to landlord repossession to between 6,360 and 8,160.

Year	Possible authorised tenant evictions due to landlord repossession	Unauthorised tenant evictions due to landlord repossession	Total evictions
2015	4,800	500 - 2,000	5,300 - 6,800
2016	5,280	550 - 2,200	5,830 - 7,480
2017	5,760	600 - 2,400	6,360 - 8,160

Is there still a problem?

The discussion above gives a sense of the plausible scale of the problem. In theory, tenants in these situations are better protected following passage of the 2010 Mortgage Repossessions (Protection of Tenants etc.). What does our data at Citizens Advice tell us about the detriments renters suffer in practice when caught up in a landlords' repossession?

Even after the Act, which improved the rights of unauthorised tenants, we still help many people who experience short-notice eviction due to landlord repossession. Numbers have roughly halved since the introduction of the Act, from around 200-250 cases per quarter to around 100-150 cases per quarter. The numbers of clients requesting help after the eviction has taken place has remained relatively stable. This is a small proportion of our wider caseload, but for the individuals involved, sometimes threatened with imminent homelessness, the detriment is substantial. This fall in the number of cases has also coincided with a period of very low interest rates, which is likely to be an additional causative factor.

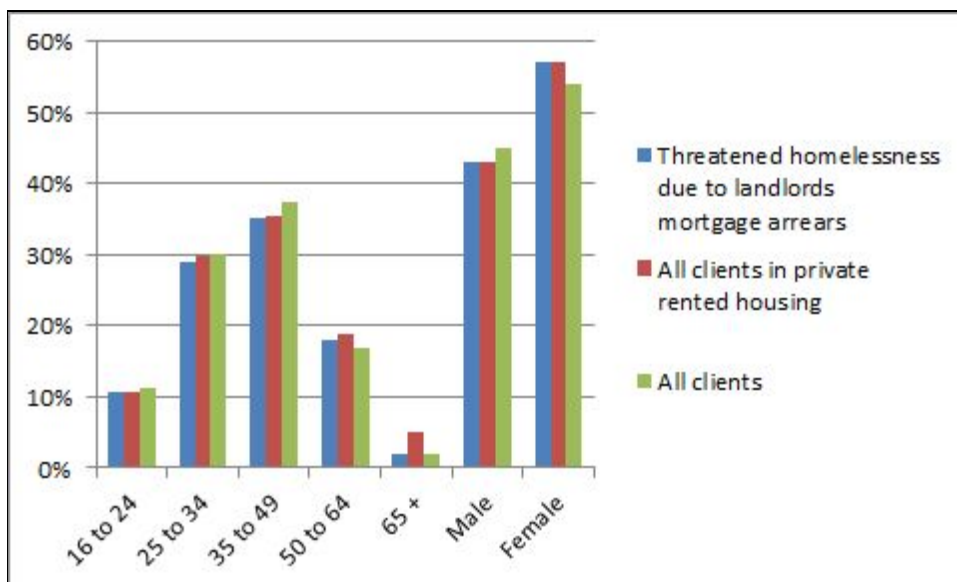
Figure 3: Tenant Eviction due to Landlord Mortgage Arrears



Notes: This graph displays the number people who approached Citizens Advice between 2008 and 2014 about threatened or actual homelessness caused by being evicted from their private rented home when their landlord went into mortgage arrears. The marker indicates the point at which the 2010 Mortgage Repossessions Act came into action.

What kind of people found themselves in this situation? We have compared the characteristics of Citizens Advice clients who requested help with this problem with Citizens Advice’s clients overall. Clients threatened with homelessness due to their landlord’s mortgage arrears are younger and more likely to be female than our clients as a whole. However, they have a similar profile to our clients in private rented housing, suggesting that these differences simply reflect the mix of clients who live in private rental accommodation.

Figure 4: Percentage of Citizens Advice clients by age and gender 2008-20



Source: Citizens Advice.

More detailed examples of the people we have helped reveal that the problem remains one of unauthorised tenants being evicted at short notice. For example:

Adrian approached Citizens Advice because he was faced with homelessness after receiving a letter telling him his landlord's property was to be repossessed in 16 days' time. The client was not informed about the repossession hearing or that he could request two months' notice. He had been living in the property for two years and was up-to-date on his rent payments.

John came to Citizens Advice in London when the mortgage lender of his private rented house threatened him with eviction. He had been living at the property for two years and was up-to-date on his rent payments. He first became aware that there was a problem when a bailiff tried to take possession of the property.

Anne and Gill came to their local Citizens Advice when they received a letter stating that their 'home was at risk'. It was through this letter that they discovered their landlord was in arrears for the mortgage and the lenders would be repossessing the property. They were unable to contact their landlord to discuss this issue. When they approached the lender they were informed that they would be evicted that weekend, despite not being given notice about the repossession hearing. The clients had been living in the property for less than six months with their children and had paid a £1400 deposit and were up to date with their rent.

Each of these cases took place after the 2010 Act came into effect, suggesting that some private tenants do still fall through the net. In some cases, it appears that tenants do not open the letter giving them information about the repossession. This may be because the letter is often addressed 'to the occupier', raising the risk that it is ignored as junk mail. Our own discussions with lenders also suggest that in

some cases tenants do read this letter, but are subsequently led to believe by their landlord that the arrears have been settled.

Conclusion and areas for policy development

The Mortgage Repossessions (Protection of Tenants etc.) Act 2010 has gone some way to protecting tenants from eviction with little notice when their home is repossessed due to a landlord's mortgage arrears. However, at Citizens Advice we are still seeing cases in which tenants in practice had little notice of an eviction. With interest rates set to rise in coming years, and our estimates suggesting 6,360 to 8,160 private renters could be caught up in their landlord's repossession, this raises a number of questions for further exploration.

First, could lenders do more to improve their practice in dealing with tenants in repossession cases? In particular, we would like to see good practices spread:

- Face to face visits to ascertain who is living in the property and to advise tenants of the upcoming repossession;
- Where possible, letters to tenants informing them of the repossession that are personally addressed and, in cases where this is not possible, clearly marked with text such as 'Your home is at risk due to repossession'; and
- Unauthorised tenants to be informed of their right to have two months' notice in cases of a landlord's repossession.

Second, given that tenants have stronger rights when their landlord holds a buy-to-let mortgage, there is a role for lettings agents to ensure that any mortgaged property they market or manage has the lender's permission to let. Good letting agents already do this and the Property Ombudsman's code of practice for Letting Agents includes a requirement to do so. It is important that all letting agents follow this practice.

Third, the development of local landlord licensing schemes offers a further opportunity to check that landlords have permission to let. Landlord licensing schemes developed by local authorities should include a condition that all mortgaged properties have permission to let from the lender before being rented, ensuring the tenant has, at a minimum, the kinds of (albeit weak) protection they are afforded as standard through the Section 21 process.

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