Market overview

- 2.65 million – UK Lanldords
- £1.7 trillion – Outstanding Mortgage Balance
- £540 billion – BTL Gross Advances between 2000-2020
- £37 billion – BTL Gross Mortgage Advances

Rising inflation, increases in cost of living and geopolitical challenges have created more pressure on an economy fresh out of the Covid pandemic.

High interest rates result in squeezed margins and the impact of new legislation in the last few years is set to push some 46,000 out of the Private Rental Sector (PRS) by the end of 2022.

The PRS is currently undergoing a structural shift whereby small and accidental landlords are being replaced by larger portfolio landlords and new, Build to Rent (BTR) schemes run by professional investors and property developers.

Continued **mortgage lending** growth has proved resilient within the PRS sector but with market uncertainty still heavily

present, the expected peak in base rate is now around 4.5% by end of Q1 2023.

Although challenging, EY expects a rebound in the second half of 2023 with a return to GDP growth.

Buy to Let overview

Buy to Let (BTL) is a residential property mortgage which has been purchased to be rented out for investment purposes. Unlike other mortgages such as **95% mortgages** part of the mortgage guarantee scheme.

There are two types of BTL Mortgages:

Unregulated (most common): Fixed term interest-only mortgages where the capital remains outstanding at the end of the fixed term period.

Regulated (less common): Mortgages issued to landlords who are renting out their properties to family members.

These mortgages are subject to tighter guidelines and are regulated by the Financial Conduct Authority (FCA).

While in interest-only BTL mortgages, the capital is outstanding at the end of the period, most lenders have provisions for an overpayment allowance (typically 10% of the outstanding balance) to allow landlords to reduce the mortgage balance and consequently interest payments.

Overpaying more than 10% may lead to Early Repayment Charges (ERC) so landlords are advised to check carefully with their brokers the details of the mortgage offer before they proceed with it.

First Time Buyers (FTB) can access BTL mortgages but there are subtle differences in what is available when it comes to the mortgage Loan to Value (LTV).

For example, a typical FTB looking to buy their first home to live in can access mortgages with as little as **5% deposit** (of course the lenders affordability and underwriting criteria must be met as well).

On the flip side, if that same first time buyer was looking at the same property as an unregulated investment the **buy to let deposit** required would be far greater with lenders asking for at least 25% deposit and sufficient rental income to support the affordability of the mortgage.

In both cases, the larger the deposit the lower the interest rate tends to be with most lenders having tiers starting from 65% LTV. That means a 50% LTV mortgage would access the same rate as a mortgage at 60% LTV.

UK landlord composition

Currently, there are more than 2.6 million landlords across the United Kingdom (an increase of 2.4% over the last three years).

2 in 3 of all landlords are based in South of England (26% in South-East; 17% in South-West and 17% in London). This is relatively concentrated considering that only 40% of the UK population lives in South of England.

Interestingly the split of female/male ratio is 50/50 and the average age is 60 which is understandable given time is required to build wealth in order to invest in capital intensive assets such as properties.

London has the highest concentration of landlords (20% of total) and has experienced the highest growth (+10%) over the last three years.

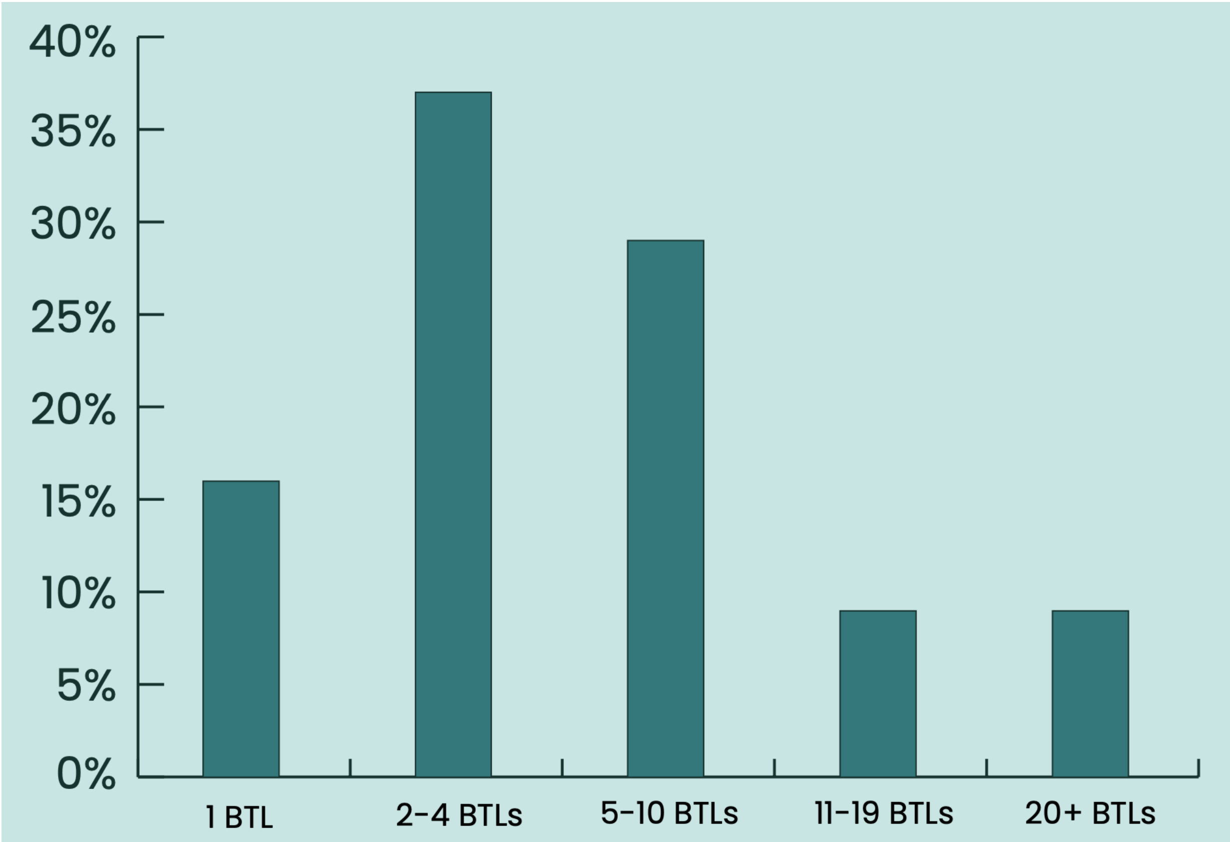
Traditionally, landlords have invested in their home cities with most of them focused on investing close to areas where they live as it is easier to manage.

However, low rental yields in London (rental yield is the gross rent over the property purchase price) have increasingly made many London landlords invest in North of England where rental yields in some cities have reached double digits (e.g. Sheffield).

While almost 1 in 2 landlords own between 1-2 BTL properties, nearly 20%+ own more than 11 BTLs. This concentration is rather understandable as economies of scale are present to a larger portfolio where funding becomes easier and there's a higher and more potentially diversified rental income on top of the equity built due to capital appreciation.

Considering these dynamics, investors who want to turn landlords will face more challenges if they want to remain and succeed in this space.

In the graph here below you can appreciate the **percentage of owners per number of properties in their portfolio, as per Q1 2022**



BTL landscape

Market Insight

Out of a total £1.7tn outstanding mortgage market, 31% is BTL related with the remaining being FTB and product switches (refinancing).

The outstanding BTL Mortgage market has seen significant growth growing from

£214bn in 2015 to £540bn in 2022.

The value of BTL gross mortgage advances in 2021 was 36.9bn or 11.6% of total gross advances.

The number of property transactions amounted to 1,184,690 in 2021 with 47,400 new BTL companies incorporated.

While interest rates have increased considerably the last few months with some BTL products reaching 8%+ it is expected that portfolio landlords may be less affected given that the different mortgage maturities in the portfolio will provide overall cushion to absorb increased rates during refinancing.

Moreover, most landlords can partly offset the higher interest cost by increasing rents.

What are landlords doing to prevent uncertainty?

With the majority of landlords facing higher mortgage costs on remortgage, 5-year fixed deals have been a popular option for those looking at mid-term stability.

This allows for regular rent reviews to take place in anticipation of rental stress tests tightening and a rebalance of the mortgage pricing whilst having one eye on a fixed budget to prevent any sharp increases in mortgage costs.

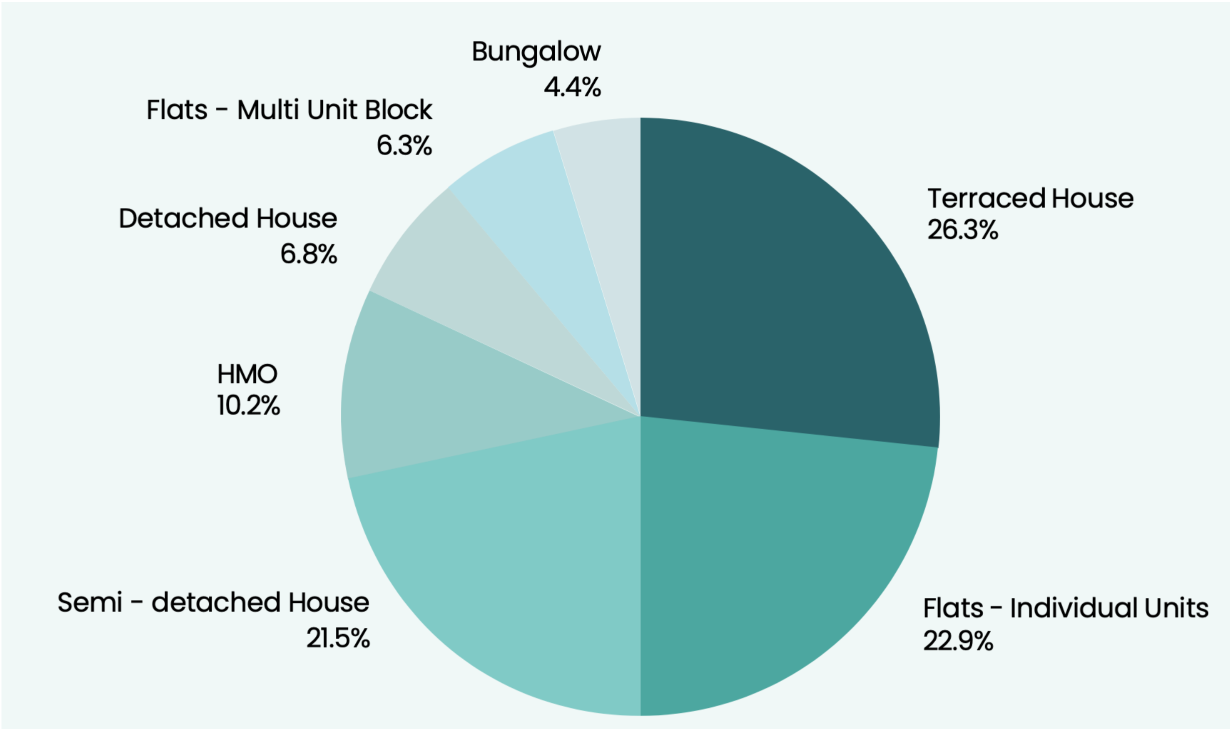
In 2022 the trend has been to see smaller landlords (those with 1-2 properties) exit the market. This is driven not only by the higher interest rates but also from overall increased **costs** to manage properties as well as the diminishing tax benefits

on the deductibility of mortgage interest payments following the 2017 changes in the tax law by the then Chancellor George Osborne for landlords owning properties in their personal name.

Mortgage product types

There are quite a few property types that property investors most commonly prefer. We note that certain types require more sophisticated knowledge and management (eg. HMOs, Mixed-use) but do allow for higher returns. Those types include:

- **Standard** – Vanilla style properties such as terraced houses and purpose-built flats.
- **HMO** – multiple unrelated tenants occupying a house or flat and sharing common areas.
- **Multi-Unit Freehold Blocks** – Single building (or block) with multiple independent residential units all on one lease. E.g. A house split into individual flats.
- **Student & Multi Lets** – Similar to HMO with multiple tenants from different households on the same agreement.
- **Semi Commercial (Mixed use)** – Combination of residential and commercial elements in one building.
- **Purpose built blocks** – individual units on one title with own entrance & tenancy agreement.



Mortgage lenders

The lending market is rather concentrated with few players dominating both FTB and BTL space.

Lloyds Banking Group leads the pack, which includes the likes of Halifax and BTL lender BM Solutions with £55.9 billion gross mortgage lending in 2021 or 20% of total.

Each lender will have their own unique mortgage criteria. There is no one size fits all approach. The market is divided into the high street, which will have an offering to meet the standard requirements usually with a dedicated offshoot or lender within the group to handle BTL and non- residential cases.

The rest of the market is then divided into challengers and specialist lenders which will handle cases that do not meet the appetite of the mainstream due to risky client profiles or properties that do not fit the mainstream mold.

High street brands

The main hub of lenders which soak up most of the BTL market can be found on the High street. Lenders such as Nationwide which also includes BTL lender TMW cater for Portfolio landlords with over 10 properties.

The appetite of the High street is very much ‘Vanilla’ based meaning BTL mortgages on single let properties owned by individuals. Approximately 68% of total gross lending in 2021 would fit here.

Challengers

Building Societies and Challenger banks (eg. Virgin Money, TSB, Shawbrook, etc.) will absorb the next tier of mortgage lending.

They tend to have more flexibility over what they will accept in terms of properties and scenarios.

Typical cases would include single let properties owned with the use of a limited company or small HMOs owned by individuals. Approximately 27% of total gross lending in 2021 would fit here.

Specialists

There is a growing market for new disruptor lenders such as Molo and Selina Finance that specialise in niche product lines.

Most cases for growing landlords up to 10 mortgaged properties with standard cases will be absorbed by the high street.

Outside of the box scenarios, larger portfolio landlords and credit impaired applicants are placed with specialist lenders such as Precise, Foundation Home Loans, Paragon and WestOne at a premium interest rate to make the risk worthwhile for the lender.

The specialist market will continue to grow as more and more non-standard scenarios such as those involving HMOs, Multi unit blocks and Semi-Commercial continue to grow.

This market is the smallest of all accounting for 5% of total gross lending in 2021.

Niche scenarios

The more niche the scenario becomes, the more of a premium on the interest rate.

This should be kept in mind when looking to invest in properties and projects.

The likes of cladding, Japanese knotweed, properties above commercial units and flying freeholds are all niche examples.

Data from Mortgage for Business shows a healthy increase in the number of niche BTL lenders in the market, currently sat at just over 50 with more and more products especially Ltd Co. being added to the market.

While property investors should mainly focus on selecting assets based on performance and investment criteria, they should also consider optimising funding from a capital allocation perspective.

The more niche the asset the more important to use a good mortgage broker with an understanding of this space given that a 1% saving with the right product on a £1m investment can result in £830 additional monthly cash in the investor’s bank account.

Mortgage calculation

Personal

Personal Affordability with BTLs is calculated by taking the projected rent of the property and comparing this with the lenders interest payments. Unlike **residential mortgages**, affordability in the BTL sector is calculated using the rent a property can generate versus a threshold the lender has set (commonly referred to as a stress test).

However, if you're doing a residential mortgage application, there are still ways you can advance your mortgage application without payslips and one of those ways is looking at the investment income you have from property for example.

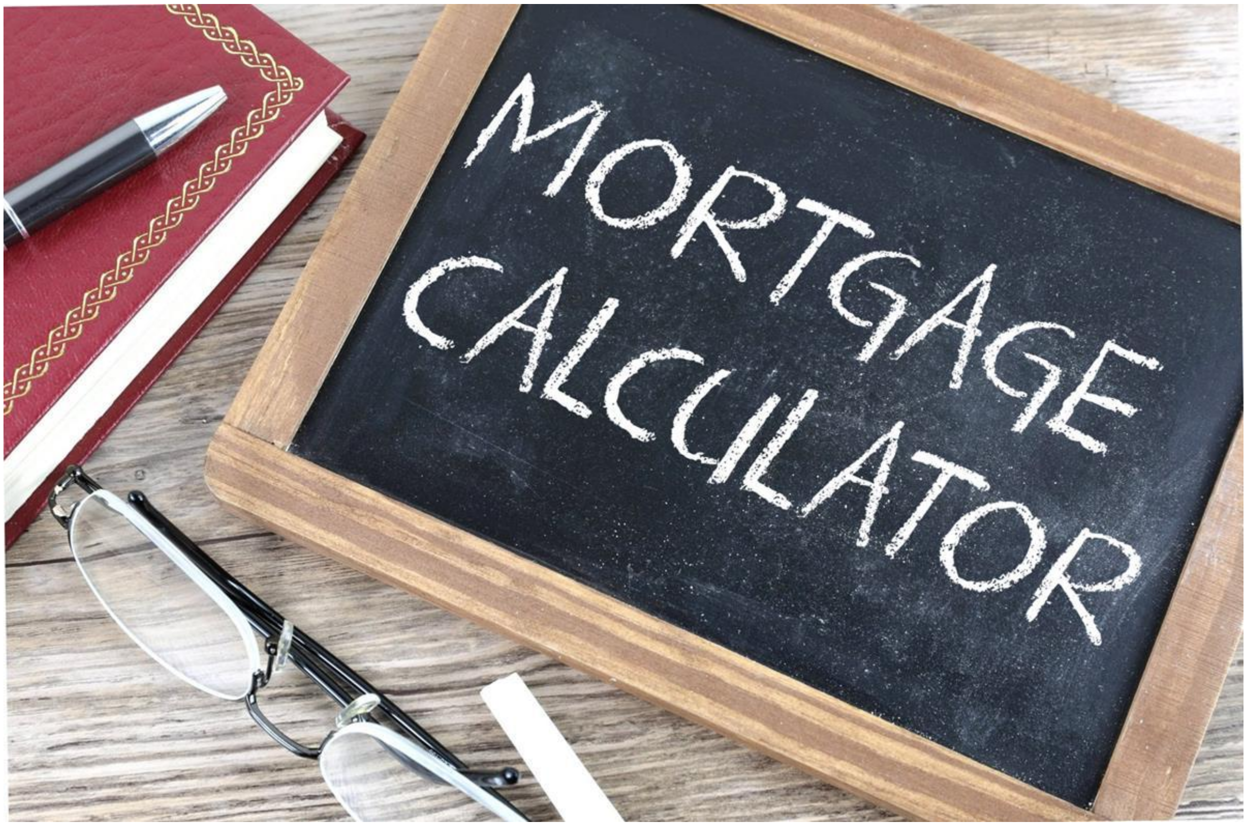
The aim is to ensure that the rent provides coverage to meet interest payments if rates were to significantly increase.

The stress test would typically be calculated at a 5.5% interest rate with an additional stress of 125% on top. For example, to calculate the available mortgage from a £1,500 monthly rent we

would proceed as follows: firstly, annualise the rent (£18,000) then divided by 125% stress test and then divide again by the 5.5% interest rate to arrive at the mortgage amount that can be supported by the stated rent.

The Prudential Regulation Authority (PRA) has tightened this up with the coverage set by lenders now being anywhere up to 170% and interest payments exceeding that of 5.5%.

However, September saw many lenders change their stance on the stress rates they apply.



Limited Company

Limited Company BTL mortgages follow a similar concept around affordability and include requirements such as Personal Guarantees from company directors.

Portfolio Landlords

Portfolio Landlords – those with 4 or more mortgaged properties will be asked to provide detailed background portfolio information.

This includes Business Plans and Cash Flow statements with the background properties having to meet a set level of coverage by some of the lenders on the market.

There can also be portfolio LTV limits in place regardless of what the subject property LTV requirements may be. For example, you may be able to achieve 75% LTV on the property you are looking to remortgage but the overall LTV of your portfolio cannot exceed an average of 65%.

As more properties come into the mix, underwriting complexity increases as lenders will take a more holistic view and will be assessing rental yields across the whole portfolio.

Each lender will have their own criteria of how they define a portfolio landlord.

Therefore, landlords with 10 or more properties need to pay attention to the rates each lender is willing to offer on the basis of differing risk profiles and underwriting approach.

Application assessment

1. Initial application

A fact-find is completed by your Broker and documents collected. Your credit file is an important part of documents collected and should be reviewed before a recommendation is made.

Once all documents have been collected and the scenario assessed, an application is submitted to the lender that best fits the situation.

2. Underwriting

The lender will assess the application and documents supplied. In some cases, they may instruct the valuation immediately, but this can be done after successful preliminary underwriting to avoid unnecessary valuation fees

3. Valuation & review

After successful preliminary underwriting, lenders will instruct a valuer from a panel of surveyors to conduct a valuation.

Once complete the report will be sent back to the lender and checked by the underwriting team to ensure the property is suitable security.

If successful, final underwriting checks will be completed and the lender will proceed to packaging the offer document, also known as the mortgage capacity report.

4. Offer & completion

The offer is sent out to the broker and is also sent across to the conveyancer to begin the process of completion.

Post completion, it is common practice to review all insurances and protection policies to ensure they are still relevant in their cover levels.

Tax Implications

Properties can be owned by individuals in many different ways. Personal, Trust, Limited Company and other structures are all common ownership types with Limited Companies becoming increasingly popular after the tax changes in interest payments were introduced in 2016.

Personal

Properties owned in personal names allow landlords to deduct all **allowable expenses** (as defined by HMRC) from rental income.

Landlords can't claim mortgage interest as an expense, but they do receive a basic rate – 20% reduction from their tax liability for any mortgage interest payments and other financing costs.

Overall, the rent received will be taxed at the marginal rate. If an individual is on the higher tax rate (eg. 40%) then the rental income will be taxed at that rate (assuming the total income doesn't exceed the amount to move to the next tax band which is 45%).

Company

Property that is owned via Limited Companies follows a different set of rules.

The allowable expenses are still deductible including all of the mortgage interest.

Rental income is initially subject to corporation tax. However, extracting profit from the company would be subject to other taxes depending on the form of extraction used (Eg. salary, dividend, etc.). Professional tax advice is required in these cases to ensure Landlords have optimised tax positions.

Both Personal and Limited Company owned properties will have to consider taxes around Inheritance, Capital Gains and Stamp duty.

Limited Company owned properties will be subject to a 25% corporation tax from 2023 compared to 19% currently.

Having a business plan with portfolio projections will help with choosing the correct setup.

Smaller landlords tend to benefit from personally owning BTLs whereas portfolio landlords often opt for Limited Companies to make use of the flexibility of the profit extraction timing and different possibilities.

Hints & tips

Below are some of our hints and tips to keep your mortgage journey on track!

1. Credit file

Check your credit report with a credit file aggregator such as CheckMyFile – individual agencies do not share information with each other so checking the main players Equifax, Experian, Crediva and TransUnion is a good starting point before any approach to a lender is made.

Check the whole report, a good **credit score** itself does not always show the real picture. Missed payments from 12 months ago may have been missed but could affect the choice of lender with most having their own policy on what they are happy to accept.

2. Business plan

Portfolio landlords are seen as business owners by lenders and their underwriting teams. Most will require you to supply a business plan with cashflow figures detailing how your portfolio is geared, the type of tenants and overall lender composition.

Having a back-up such as a savings slush fund or Rent Guarantee Insurance is always a good indicator that you are not living month to month and risking vacancy periods with no cash in the bank to keep paying the lender should the worst happen.

3. Appetite check

Most lenders will have a sales team available to check over the appetite and details of a case to give an indication if the application meets the lenders criteria.

This is beneficial for new build applications where a lender may have exposure limits on the number of units they are happy to have on their books from that development.

4. Staying put

When remortgage time comes round make sure you check to see what options are available with your current lender as it can vary depending on if the property was **unencumbered** or not.

Sometimes the product switch options are attractive and require very little admin to get arranged. Having a good business plan will help guide you on the correct product strategy.

BTL mortgages now and beyond

Current forecast

Reports across the market indicate the UK mortgage market is heading for a slowdown with marginal growth of 0.7% in 2023 due to falling levels of household income and rising mortgage costs.

These are figures from the latest EY ITEM Outlook for Financial Services forecasting 2023 as the lowest year of mortgage growth since 2011.

BTL mortgage response

The mortgage market has already reacted to the economic volatility. Lenders are pulling products to reprice and an overhaul on mortgage affordability is underway. BTL lenders are reviewing their stress tests and tightening regulation.

This has left some landlords having to stay put. Staying with current lenders via product switches or in some cases, where the option is not offered on variable rate products, exposing them to unfixed mortgage costs further reducing the profit margins that have already been pushed throughout Covid-19 with little chance to recover after the black swan event of 2020.

Market insight

With continued Bank of England base rate rises, the fight on inflation is still one in full flow with few signs of reducing volatility in the market short term.

With the rate of borrowing being passed on imminently, savings are still lagging behind with some way to go.

With growing market pressure and further U-turns in Government policy it will take some time before stability is restored and a new baseline is established for cost of living and borrowing.

Given the size of the Private Rental Sector (PRS), BTL lending and the importance of the sector in providing housing to 12+ million tenants across UK the sector is here to stay albeit with a twist.

An increasing focus is being placed on portfolio (experienced) landlords and/ or professional Build to Rent (BTR) operators who can operate at scale and professionalise the service. This will naturally push out accidental and non-business-orientated landlords with rising costs and changes in regulation.

Build to rent

According to the British Property Federation in Q2 of 2022 there were 237,000 completed, under construction or in planning build to rent properties in the UK.

The sector has been experiencing year on year growth with major investors including the likes of Lloyds Banking Group which has set its eyes on becoming the biggest player in the build to rent space.

Final thoughts on buy to let mortgages for landlords and property investors

The BTL space has shown that even with uncertainty, market volatility, legislation changes and a squeezed profit margin the sector is resilient and able to cope with many challenges that has faced and is currently facing.

The sector will continue to become more professional with standards across the board being raised as a way of driving out unprofessional and substandard landlords which will further grow the glow of appreciation towards the majority of landlords going above and beyond to deliver safe and affordable housing to a tenant population in desperate need of accommodation.

There will be more challenges to come as we approach the end of 2022 and 2023 looks to be a year of managing rough tides to see out calmer times with a light at the end of the tunnel still present.

How can we help? Lofti aims to support all those in the property sector by continuing to invest in a tech-first approach to put efficiency and simplicity at the heart of all things property in a thriving private rental sector.

FAQs

1. What is a BTL Mortgage?

A BTL is a specific type of mortgage used for buying property that will be let out to tenants.

2. What level of deposit do I need to purchase a BTL?

Typically, a standard deposit for a BTL mortgage is around 25%, there are lenders that will consider less but the rate will come at a premium.

3. What kind of BTL Mortgages are available?

You will find the same kind of options available as you would for a standard mortgage, including tracker, fixed, and discounted rate products.

4. Why is a credit file relevant?

Your credit file will help detail your full financial picture and can sometimes dictate the lender you end with dependent on your account conduct.

5. What should I look out for when looking at a BTL to invest in?

Make sure you have done your research on the numbers including expected rental income, property costs, any licenses you may need, the area itself; is the property above commercial use and if so what type? These are a few considerations you take as part of your due diligence.

6. Is there a difference in the process for applying in personal name VS Limited Company?

Both will follow a similar process when the lender looks to underwrite. **Personal Guarantees** and SIC code checks are more for Limited Company applications to ensure it has been setup correctly.

7. What is Consent to Let?

This is a form of agreement with a residential lender allowing you to rent out your home without having to convert it to a BTL mortgage. It is usually a temporary agreement which lasts for around 12 months and will be reviewed by the lender at the end of the agreed period.

8. What is Let to Buy?

This involves letting out the property you live in so you can buy a new one to live in. The existing residential mortgage will be switched to a BTL and if possible, equity can be extracted from it to help with the forward purchase.

9. Are Holiday Lets looked at differently when it comes to affordability?

They will look at seasonal rents due to the fluctuations experienced in low, medium and high seasons. Be prepared for more questions and stricter underwriting from lenders in this niche.

10. Why Should I use Lofti?

With Lofti you can manage all of your property information and compliance in one place with access to the Lofti **Mortgage Advice** Service which is dedicated to Landlords and the BTL Mortgage space. All of this, completely fee FREE.

11. What is Top Slicing?

This is where a BTL lender uses personal income to top up any shortfall in the requested mortgage amount.

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