Consultation response

Department for Work and Pensions informal call for evidence:

Support for Mortgage Interest

February 2012

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Introduction

Support for mortgage interest (SMI) provides a lifeline to nearly quarter of a million people who are struggling to keep up with their mortgage costs. SMI claimants include vulnerable and low income homeowners, unable to make ends meet in old age or due to job loss, disability, or the cost of caring or lone-parenting. This is a vital safety net that helps to prevent homelessness. It is also extremely cost effective, with the average weekly payment to recipients just £30.

We are disappointed that the government has not taken this opportunity to review and reform the safety net for homeowners more holistically. Millions are struggling to pay their housing costs and often resorting to risky credit in order to keep their heads above water.[1] Job security for many is low and interest rates will inevitably rise at some point, while high inflation has put a squeeze on household finances. As a result, the Council of Mortgage Lenders predict that there will be 45,000 repossessions in 2012. Take-up rates of private insurance are low and government schemes, such as the Mortgage Rescue Scheme, are inevitably limited. A longer term settlement, where all parties (the borrower, lender and the government) contribute to a strong safety net is desirable.

However, we welcome the opportunity to contribute evidence to this consultation. The proposals outlined in the consultation may make sense in isolation, but when they are combined they make SMI a fairly unattractive option for borrowers - it is not paid at full rates so may not be sufficient to stay out of debt, it needs to be repaid with interest, has a long waiting period, cuts off completely if the claimant returns to work and only covers a limited amount of capital. Our concern is that households will either give up and hand their keys in, sink further into debt and face enforced possession, or resort to other means than SMI to pay their mortgage, such as taking out expensive or risky credit.

Shelter's key recommendations are:

- The waiting period for receipt of SMI should not revert to 39 weeks as this would increase likelihood of arrears and repossessions
- In order to avoid both shortfalls and over payments, the government should pay SMI at actual, not nominal rates (within reason)
- Mortgage Interest Direct, where payments are made directly to lenders, should be retained
- Better transitional arrangements are needed for borrowers who have time-limited SMI
- A regime for recouping the costs of SMI from claimants carries a number of risks which need to be more carefully considered

Putting a charge on property

Q1: Do you think payments for support for mortgage interest should be recouped from claimants who are in receipt of help on a long term basis?

Recouping benefit costs from claimants is a fundamental policy change that does not currently operate in any other area. It means that SMI is, in effect, no longer a benefit but a state-funded loan. Continuing to call it a benefit is ambiguous and could confuse claimants, particularly if it is incorporated into Universal Credit where it will be, from a claimant's perspective, indistinguishable from other benefit income.

While we understand the argument that the state should not subsidise capital gains and personal asset accumulation, this is somewhat at odds with other government drives including initiatives such as generous Right to Buy discounts and favourable taxation of housing assets. Private landlords do not need to repay their tenants' housing benefits, but clearly gain from both the yields and capital gains that housing benefit helps to enable.

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1 http://media.shelter.org.uk/home/press_releases/almost_one_million_people_resorting_to_payday_loans_to_help_pay_rent_or_mortgage

Singling out SMI claimants, low-income people who are mainly older or disabled and already receive less favourable support than renters, sets a worrying precedent and needs to be carefully considered.

In addition:

- SMI only pays mortgage interest, not capital repayments, so the government is not paying off people's mortgages as has been suggested.
- Mortgage lenders benefit from SMI and are not having to repay anything to the state.
- SMI is a cost-effective solution, compared to the high costs of homelessness or housing benefit payments, [2] so the state already realises cost savings through SMI.
- Recouping costs might encourage more claimants to hand their keys in or sell rather than take on extra debt. This could ultimately result in the state paying more through the additional costs of re-housing and paying housing benefit, and particularly costly for long term claimants with a disability who live in adapted property.
- Recouping costs would diminish pensioners' equity, which they may be reliant on for care costs. Because there is no data on the current value of claimants' properties we do not know how much the average pensioner would stand to lose. Shelter favours a system that is linked to property value instead (see Q4) as we believe this would be fairer and in line with the government's aims than charging full SMI costs.

Q2: What period of time would represent a long term basis? For example two years?

We agree that two years is an appropriate cut-off point between short term help, intended to give people breathing space to get back on their feet, and long term help where a borrower, most likely a pensioner or long term disabled person, is unlikely to find a new income stream and repay the mortgage.

Q3: What are your views on the idea of recouping support for mortgage interest payments from long-term claimants through a charge on their property?

We are not convinced that the charging order proposal, where the government reclaims the total amount of SMI paid over the years through a charge on the property, would meet the stated objective of value for money for the tax payer:

- For claimants with a relatively low amount of SMI (such as the £5,200 example set out in the impact assessment), the government would not make significant gains, when offset against the administrative costs of running the charging order scheme. The government has proposed adding interest to the charge to offset costs, but we consider this to be very unfair to the homeowner as it will only increase their debt.
- For any claimants, the proposal requires that they have enough equity to repay the loan once the main mortgage and any other debts secured on the property had been paid. Some properties will have fallen into negative equity.
- This does not represent the taxpayer sharing in the homeowners' asset accumulation; it reflects size of mortgage not size of gain, i.e. property value.

This option may be appropriate if linked to an ongoing Mortgage Rescue Scheme safety net, where the charge could be released by selling the home to a housing association. The household could then remain in their own home. However, we recognise that the Mortgage Rescue Scheme is not currently set up as a permanent feature of the safety net, nor is it universally available.

Q4: Are there other ways the government could recoup or reduce the cost of long-term SMI claims?

[2] Shelter Cymru, for example, cite a case of a couple in south-east Wales who faced possession proceedings following the reduction of their SMI from £147 to £81 a month. The household was accepted as homeless and re-housed in a Housing Association property, claiming Housing Benefit at more than twice the original SMI rate.

We suggest that any recouping of costs is only on the asset accumulation that the borrower would not have received without SMI. This could involve a valuation at the end of a claim, with the government taking the appropriate portion by means of an interest-free equity loan. If the borrower's circumstances change so that they not longer receive SMI, but they do not sell the property, they could have the option of paying it off in regular instalments.

Q5: Should there be a period of grace before the charge is applied?

The charge should not be applied for the first two years of a claim, this would enable SMI to be a straightforward, short term safety net for people who may be able to get back on their feet.

Q6: Once it is applied should it relate to the total value of the support provided?

We believe that the government should only try to recoup a proportion of asset gains, not the whole amount of benefit paid over time. However, if the proposal goes ahead, we recommend that there is a cap on the total amount government can recoup so as not to cause significant hardship to homeowners. The first two years of a claim should be excluded.

Q7: Should the proposal to put a charge on a property be extended to cover all recipients of SMI, effectively abandoning the two year limit in place for claimants who receive SMI with Jobseeker's Allowance or its future equivalent with Universal Credit?

The charge should only cover long term claimants.

Standard Interest Rates

Q8: Do you think that the current method of calculating the standard interest rate is the fairest and most effective method?

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Q9: Is there another method of calculating a standard interest rate for SMI that may be fairer or more effective?

A standard rate will always have negative outcomes for some borrowers, and will often have to change in response to external circumstances such as base rate changes, leaving borrowers with little certainty and vulnerable to sudden rate reduction shocks. This was the case when the previous rate, which had been temporarily frozen at 6.08%, was changed to the current formula, paying out at 3.63%. The change in rate has had significant negative consequences on many Shelter clients who, often with very little notice, have found that their rate had plummeted by 40% and their mortgage was no longer affordable. Shelter's helpline and face to face advice services saw a huge increase in enquiries from worried homeowners:

- One client with serious health problems, who claimed ESA and DLA, had a huge payment shortfall of £92 per week following the rate cut - but was stuck on a high fixed-term rate for another year. Like many of our other clients, he simply had no room for manoeuvre in his tight budget.
- Many of our clients were already in arrears, which the rate change exacerbated. But some, such one pensioner, with very serious health problems, had small loans and positive equity. None the less, the rate change meant that she struggled to meet the shortfall as her interest rate was slightly higher.

Constantly changing the rate, and using complex formulas, leads to consumer confusion. The Department for Work and Pensions gave claimants scant warning of the last rate cut, with many receiving notification of the change just days before it kicked in, leaving them with very little time to prepare for their drop in payments. The letter sent to claimants also contained several serious mistakes – stating, for example, that clients could claim Housing Benefit, which they cannot. This left claimants confused about their options and advice agencies picking up the pieces.

A standard rate will mean that some borrowers lose out, particularly those on high interest sub-prime mortgages and those locked into fixed rate deals who are unable to re-mortgage to a better rate that more closely resembles the standard rate. At the same time, it means the government is always likely to be making some over-payments.

We suggest that the principles underlying a rate should include:

- The rate paid should reflect, as far as possible and within reasonable limits (e.g. with an upper limit in place), the amount actually owed rather than a nominal amount.
- The rate should be easy for borrowers, advisers and lenders to understand and should create some certainty so that they can be sure of how manageable payments will be. It should be widely and clearly communicated.

Paying rates at actual levels on individual mortgages would, according to CML analysis, save the government around £26 million a year, with further savings possible if a maximum cap were introduced.[3] We do not agree with the DWP's assessment that this system would increase fraud due to borrowers failing to declare whether their rate had changed. If a system were introduced where lenders reported rate changes, or 'billed' the DWP for total costs, there would be no need for a borrower to report. There would be some administrative complexity upfront, but we believe this would even out over time as the DWP realised savings and fewer borrowers faced losing their homes, which is very costly to the taxpayer.[4]

If the government persists with a Standard Interest Rate formula, we propose that arrangements are made to allow borrowers to move off higher fixed term rates or to provide top-ups to borrowers with a shortfall.

Q10: Should any action be taken in respect of the treatment of 'excess SMI' payments – if so, what?

If payments were made at actual contractual rates, this would not be an issue. The current system of paying directly to lenders, which we think should be retained, ensures that any excess payments go directly towards the mortgage.

Mortgage Interest Direct

Q11: Do you think that it is the right policy to move away from the Mortgage Interest Direct scheme for most claimants?

Individual payments may be consistent with the over-arching principles of Universal Credit, but in practice they create problems for low income households in all tenures. We do not think that moving away from paying SMI directly to lenders would be the right policy in this case:

- There is a strong risk that lenders would assess the risk of non-payments as too great and become less engaged with SMI and exercise less forbearance.
- SMI claimants often face complex and stressful financial circumstances and struggle to prioritise their debts effectively. Ensuring that their housing costs are prioritised through paying lenders directly means that they do not risk paying off other creditors first and becoming vulnerable to homelessness as a result. It is practically difficult for people on very low incomes to have large sums of money passing through their bank accounts when this could be swallowed up by other direct debits, overdraft charges etc.
- There is little evidence that the current system of direct payments encourages benefit dependency; most of those claiming SMI are of pension age and highly unlikely to return to

[3] http://www.cml.org.uk/cml/publications/newsandviews/106/398

[4] http://england.shelter.org.uk/professional_resources/policy_and_practice/policy_library/policy_library_folder/briefing_immediate_costs_to_government_of_losing_a_home

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work in any case. For those of working age, most will have been in work previously and will have a strong incentive to return to work quickly.
- Borrowers do not have any choice about their mortgage payments - part of the purpose of paying individuals in other areas is to encourage them to shop around, but a mortgage payment is a fixed monthly cost.

If this policy is pursued, we think that borrowers should have the option to have payments made direct if they choose.

Q12: If we move away from paying support for mortgage interest by Mortgage Interest Direct in what exceptional situations should claimants have their mortgage interest payments made direct to the lender and what criteria could be used to determine when this should happen?

We do not agree that Mortgage Interest Direct should be scrapped, but if payments are to be made directly to claimants a system should operate whereby households can request to have payments made to lenders.

The treatment of home improvement loans

Q13: Do you think that the Department should move to a simplified approach for home improvement loans, subject to a cap on the amount of loan on which interest is payable?

We agree that these rules should be simplified.

Linking rules

Q14: Do you agree that the 12 and 52 week rule should be retained for SMI purposes?

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Q15: Do you agree that certain other linking rules should no longer apply as a simplification measure flowing from the introduction of Universal Credit?

We have no specific evidence on the effectiveness of the current linking rules, but are broadly supportive of simplification.

Time limiting

Q16: Should certain categories of claimants, for example lone parents and people with a disability, moving onto Jobseeker's Allowance (or the equivalent within Universal Credit) be exempt from time-limiting?

Removing the exemption would be consistent with Universal Credit principles, but good transitional arrangements will be needed for those who can no longer sustain home ownership as a result of the time limit. SMI should be more closely linked to wider safety nets such as the Mortgage Rescue Scheme.

Q17: Should there be a limit on the number of times a claimant can access two years of SMI?

It is reasonable that a two year claim can only be made once.

Waiting period and capital limit

Q18: Have either of these two measures (13 week waiting period or £200,000 capital limit) been effective in reducing the likelihood of repossession? Where possible please supply evidence to support your response.

Shelter is strongly supportive of the shorter, 13 week waiting period. Making claimants wait for 39 weeks, the previous level, before they can receive support is unacceptable. Lenders would rapidly lose confidence with the scheme and move to possession action much more quickly. The shortened waiting period should be a permanent feature of SMI. The longer waiting period was intended to encourage take-up of private insurance but it is clear this has not been effective. Evidence suggests that 44% of claimants developed arrears in the 39 week wait.[5]

The higher capital limit, £200,000, should also be retained and regularly reviewed; the £100,000 limit was set in the 1990s when property values were much lower.

General

Q19: Do you have any suggestions for options for SMI in the medium and long term that have not been covered elsewhere in this document?

The current system time limits SMI for claimants of Jobseeker's Allowance to two years. Recent research for DWP noted that:

"There is uneven awareness among claimants of the intended time limit on SMI for JSA recipients. This should (at least) be more clearly flagged, as at present some claimants do not know about this and are, therefore, not making active plans to cope with the change in their circumstances. This is a further issue of information and communication from the Jobcentre Plus. More broadly, though, two years may be too short for the cut-off, given current housing and labour market conditions (already unemployment is predicted to rise, rather than fall, into 2011). There seems no doubt that most claimants would quite rapidly need to sell up or face arrears and ultimately repossession if their SMI payments ceased."[6]

While we do not oppose time-limiting of claims for jobseeker claimants, it is clear that better transitional arrangements and communications are needed so that they do not face sudden eviction at the end of the time limit. The case study below illustrates some of the problems caused by the time limit:

- A couple with three dependent children came to Shelter for advice. The husband had been made redundant in January 2009 and claimed SMI, which stopped in April 2011 under the two year rule. The clients didn't even know that SMI was due to end until lender informed them. The couple were in arrears as SMI did not meet their full contractual payments and lender started possession proceedings.

We urge DWP to come forward with proposals for improving communications with borrowers and working more closely with other organisations such as local authorities and advice agencies to help borrowers avoid homelessness.

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[5] http://www.jrf.org.uk/sites/files/jrf/F429.pdf
[6] http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep711.pdf

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Until there's a home for everyone

In our affluent nation, tens of thousands of people wake up every day in housing that is run-down, overcrowded, or dangerous. Many others have lost their home altogether. The desperate lack of decent, affordable housing is robbing us of security, health, and a fair chance in life.

Shelter believes everyone should have a home.

More than one million people a year come to us for advice and support via our website, helplines and national network of services. We help people to find and keep a home in a place where they can thrive, and tackle the root causes of bad housing by campaigning for new laws, policies, and solutions.

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