DWP Department for Work and Pensions

An evaluation of the January 2009 and October 2010 arrangements for Support for Mortgage Interest: the role of lenders, money advice services, Jobcentre Plus and policy stakeholders

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In January 2009, a range of temporary measures were introduced to provide additional help to owner occupiers with a mortgage who were eligible to claim out-of-work benefits, and thereby prevent possessions. The research, commissioned by The Department for Work and Pensions, explored the responses of lenders, money advisors, Jobcentre Plus staff and key policy stakeholders to these changes and the impact of these responses on the effectiveness of Support for Mortgage Interest (SMI), which is paid direct to lenders. The arrangements for SMI introduced in January 2009 were:

- eligibility for SMI at 13 weeks for borrowers in receipt of Jobseeker's Allowance (JSA), Income Support (IS) or the Employment and Support Allowance (ESA);
- fixing the Standard Interest Rate (SIR) at 6.08 per cent;
- an increased eligible capital limit of £200,000 for new working-age claimants;
- a two-year limit of the receipt of SMI for new JSA claimants.

These arrangements were subsequently amended:

- from October 2010 the SIR was reduced to 3.63 per cent.

The research explored the impact of each of these changes, and followed an earlier survey exploring the impact of the 2009 changes as perceived by JSA, IS, ESA, Disability Living Allowance or Carer's Allowance recipients of SMI, particularly those affected by the new temporary arrangements (Munro *et al.* 2010).

In-depth qualitative interviews were undertaken with nine lenders, six money advice workers, staff in six Jobcentre Plus offices and three key stakeholders.

Key findings

1. From January 2009 to October 2010, SMI was highly effective. As a result of the changes some borrowers avoided arrears. Others accumulated arrears more slowly while a significant gap between the SIR and the borrower's actual mortgage rate allowed some to accumulate a buffer. The SMI changes were implemented in a context of falling interest rates and this 'added value' to SMI.
2. The SMI changes underpinned lenders' willingness and ability to forbear and not seek possession. Lenders were more prepared to consider conversion to interest only mortgages thus ensuring the maximum impact of SMI. Money advisors and key stakeholders noted that it was easier to agree forbearance for their clients with lenders. Many new claimants, however, had little knowledge or understanding of SMI.
3. SMI was not equally effective across all borrowers. Those with higher rate loans, older mortgages, mortgages above the capital limit, or who had extensive equity withdrawal and ineligible costs could still face a gap between payments due and SMI receipts. While SMI may be effective in its own terms, where there are significant non-qualifying loans, the receipt of SMI will not preclude arrears on the mortgage as a whole, and as a result may lead to possession.

4 Where lenders were not willing, or able, to convert capital and interest mortgages to interest only mortgages, the effectiveness of SMI was reduced as the borrower still had to meet capital payments to preclude arrears.

5 The introduction of a two-year limit for new JSA claimants had no impact on the way lenders responded to borrowers in arrears in 2009. Lenders were unable to identify which borrowers in receipt of SMI might be affected by this constraint.

6 Although eligibility for SMI can often be straightforward, the effectiveness of SMI can be constrained by shortcomings in the assessment and administrative processes. Lenders, borrowers and Jobcentre Plus all contribute to these shortcomings. They include: the non-identification of likely SMI cases at the first claims stage or on transfer of benefit; borrowers' inability to provide complete information on the purpose of a loan; a failure to return forms promptly to Jobcentre Plus; and poor communications between all parties. As a result, there can be delays and incorrect assessments of eligible interest. Borrowers may face financial costs including arrears. Many of these shortcomings were exacerbated by the rapid increase in workload within Jobcentre Plus in early 2009.

7 Overall, however, the 2009 changes resulted in more people being assisted, more fully and sooner. Borrowers accrued lower levels of arrears or none at all, or secured a buffer, and in the context of earlier payment and an SIR of 6.08 per cent lenders have been more willing to forbear and not seek possession.

8 Lenders were very concerned by the October 2010 reduction in the SIR to 3.63 per cent. All lenders had a preference for payment of SMI at the borrowers' actual interest rate, but otherwise for a more gradual adjustment. A small minority would have preferred some lengthening of the waiting period (but not a return to 39 weeks) to the rapid and significant drop in the SIR. The time scale for the introduction of the change gave borrowers and lenders little time to plan for reduced SMI help.

9 After October 2010, most lenders reported an increase in the number of borrowers with shortfalls on their payments. The full impact of the reduction in the SIR could, however, be masked by the previously generous rate that had provided some borrowers with a buffer. Even with this cushion, SMI is now less effective than it was between January 2009 and September 2010 in terms of preventing or limiting arrears.

10 Lenders are now increasingly prepared to reconsider their forbearance approach as arrears mount. There is a range of responses, but the growing shortfalls, the continuing sluggish economic conditions (as well as tighter regulatory arrangements) are facilitating a change in sentiment and, potentially, a change in forbearance practices.

11 Money advisors and key stakeholders noted that some lenders were moving faster than others towards a reassessment of forbearance. Money advisors reported that it was becoming more difficult to negotiate forbearance agreements with some lenders on behalf of their clients. There were a limited number of SMI recipients coming through to the courts for possession.

12 All interviewees were concerned about the way in which the October 2010 change in the SIR had been implemented. The system produced letters used by Jobcentre Plus were difficult for some borrowers to understand, inaccurate on some details, and the short notification period gave borrowers little time to plan for a significant change in the support received towards their housing costs.

13 The impact of the two-year limit on SMI for new JSA recipients as from January 2009 is now materialising. Lenders were becoming aware of a small number of cases; money advisors to a greater extent. Both noted that borrowers were poorly informed about the potential ending of their SMI. While it is still too early to know the likely scale of claims ended and lenders' responses, lenders, money advisors and key stakeholders noted that after two years forbearance , and with borrowers still without employment (and particularly if not eligible for mortgage rescue), there was likely to be little scope for any action other than possession.

Key issues for policy makers

Respondents noted that SMI is the core support to borrowers with payment difficulties, with other initiatives such as the Mortgage Rescue Scheme (MRS) playing a supporting role. Ensuring the maximum take up and impact from SMI is, therefore, crucial if it is to contribute fully to limiting possessions.

1 Better awareness of SMI

SMI is a poorly recognised and poorly understood component of benefit. Given its core role in the safety-net for homeowners addressing this is a key issue.

2 A more effective delivery process

The difficulties faced by Jobcentre Plus in implementing the changes to SMI in the time frame available (particularly the October 2010 change) indicate a need to consider how changes are notified. Other problems in relation to the delivery of SMI, for example, the failure to identify a proportion of potential SMI claimants at the first claims stage, also need to be addressed.

3 The merits of standard rates against actual rates

A SIR, while administratively beneficial, can distort payment profiles giving rise both to excess payments and underpayments in an unplanned manner that could appear arbitrary. It relates poorly to the range of mortgage products available and may disadvantage the most vulnerable homeowners-many of whom have higher rate loans. Potentially, it makes it more difficult to secure a commitment to forbear across all lenders. The transparency of payments and what SMI covers can be masked by an SIR. In contrast, payment of SMI at actual rates is cumbersome and could encourage lenders to raise rates. A critical issue is finding the level of SIR that minimizes the distortions noted and is reasonably responsive to actual changes in interest rates.

4 Maintaining SMI

The 2009 changes to SMI were, in effect, a recognition of the failure of the safety-net arrangements in place at the time and, in particular, the failure of private insurance. The effectiveness of SMI between 2009 and October 2010 has been demonstrated, notwithstanding some clear limitations. Any further curtailment of SMI is likely to escalate unsustainable home ownership.

5 Rethinking the two-year JSA/SMI limit

Most JSA claimants find work within two years, but the current level of unemployment suggests that the proportion of JSA claimants unable to achieve work in the time-frame may increase. The timing of the withdrawal of SMI to JSA recipients is unfortunate and counterproductive if possession follows. More thought needs to be given to the early identification of long-term JSA cases and the development of more imaginative approaches to their housing futures. Without this there is a danger that the short term benefits of significant SMI support (and public money) will be lost.

6 The relationship of SMI to contemporary mortgage and housing markets

The historical position whereby SMI typically met all a borrower's mortgage interest now pertains less frequently, as rising equity and competitive finance markets have enabled homeowners to secure loans on their property for what, under the SMI regulations, are deemed non-eligible purposes. Thus, while SMI may be effective in its 'housing' remit, in terms of the larger policy objective of preventing homelessness it is inefficient where ineligible costs cannot be serviced such that arrears accumulate and possession results. There needs to be a debate about what the appropriate scope of SMI should be.

7 Delivering a soft exit from homeownership

The full impact of the interest rate reduction for all SMI recipients and the withdrawal of SMI for JSA claimants after two years will emerge slowly, but is likely to lead to an increase in unsustainable homeownership including possessions. For good reasons, policy to date has been directed towards the prevention of possession, not least to avoid the costly and detrimental impacts, including homelessness. The only alternative to possession has been mortgage rescue which has limited eligibility and medium-term funding for MRS is uncertain. Even where borrowers recognise that their ownership is unsustainable, they may find it difficult to exit successfully given the current state of the housing market, or do so with continuing financial liabilities due to negative equity. Given these circumstances, and the continuing wish to limit possessions, additional and different responses to possession are required.

These might include:

- Assisted Voluntary Sales (AVS), where the lender provides some assistance to a borrower to sell;
- enhancing rather than curtailing the MRS;
- an enhanced version of SMI, but used to take small equity stakes (cashed in on sale) where the borrower retained positive equity. This would constitute a variant of mortgage rescue (where there is currently an equity option).

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 84712 974 1. Research Report 740. May 2011).

You can download the full report free from: http://research.dwp.gov.uk/asd/asd5/rrs-index.asp

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