



Deposited via The University of York.

White Rose Research Online URL for this paper:

<https://eprints.whiterose.ac.uk/id/eprint/73805/>

Version: Published Version

Monograph:

Ford, J, Wallace, A, Munro, M et al. (2011) 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. Research Report. Department for Work and Pensions Research Reports, RR740 . Department for Work and Pensions , London.

Reuse

Items deposited in White Rose Research Online are protected by copyright, with all rights reserved unless indicated otherwise. They may be downloaded and/or printed for private study, or other acts as permitted by national copyright laws. The publisher or other rights holders may allow further reproduction and re-use of the full text version. This is indicated by the licence information on the White Rose Research Online record for the item.

Takedown

If you consider content in White Rose Research Online to be in breach of UK law, please notify us by emailing eprints@whiterose.ac.uk including the URL of the record and the reason for the withdrawal request.

Research report

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

by Janet Ford, Alison Wallace, Moira Munro, Nigel Sprigings and Susan Smith

Department for Work and Pensions

Research Report No 740

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

Janet Ford, Alison Wallace, Moira Munro, Nigel Sprigings and Susan Smith

© Crown copyright 2011.

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence.

To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

This document/publication is also available on our website at:
<http://research.dwp.gov.uk/asd/asd5/rrs-index.asp>

Any enquiries regarding this document/publication should be sent to us at:
Department for Work and Pensions, Commercial Support and Knowledge Management Team,
Upper Ground Floor, Steel City House, West Street, Sheffield S1 2GQ

First published 2011.

ISBN 978 1 84712 974 1

Views expressed in this report are not necessarily those of the Department for Work and Pensions or any other Government Department.

Contents

Acknowledgements.....	v
The Authors.....	vi
Summary	1
1 Introduction	6
1.1 Background.....	6
1.2 Research into the effectiveness of the 2009 changes to SMI	7
1.2.1 <i>Phase 2: rationale and scope</i>	7
1.3 Structure of the report.....	8
2 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus.....	9
2.1 Introduction.....	9
2.2 The response to the 2009 changes and to SMI in particular.....	9
2.2.1 <i>Impact of the 13 week wait period</i>	10
2.2.2 <i>The Standard Interest Rate</i>	11
2.2.3 <i>Higher capital values</i>	14
2.2.4 <i>The two year limit on SMI for new JSA claimants</i>	14
2.3 Implementing the SMI changes.....	15
2.4 Summary and conclusions: the effectiveness of the 2009 SMI changes	16
3 Limitations on the effectiveness of SMI.....	18
3.1 Introduction	18
3.2 Implementing the SMI changes; the administrative process.....	18
3.2.1 <i>Identification of claims</i>	18
3.2.2 <i>Incomplete information</i>	20
3.2.3 <i>Poor and limited communication</i>	21
3.3 Implementing the SMI change: contextual constraints	22
3.3.1 <i>Interest-only mortgages</i>	23
3.3.2 <i>SMI in the context of non-qualifying loans</i>	23
3.4 Summary and conclusions.....	24

4	The responses to and impact of the reduction of the SMI SIR in October 2010 and preliminary evidence of the impact of the two year limit on SMI for some claimants ...	25
4.1	Introduction.....	25
4.2	The response to the reduction in the standard interest rate	26
4.2.1	<i>Overpayments and shortfalls</i>	27
4.2.2	<i>Lender forbearance</i>	28
4.2.3	<i>Two year time limit</i>	31
4.3	Communication/Implementation of changes	33
4.4	The effectiveness of SMI post October 2010.....	34
4.5	Summary and conclusion	34
5	Conclusions	35
5.1	Key findings.....	35
5.1.1	<i>How lenders, advisers, key player and Jobcentre Plus approached and responded to the SMI changes</i>	35
5.2	The impact on the effectiveness of SMI	36
5.3	Broader policy implications	37
5.3.1	<i>Better awareness of SMI</i>	37
5.3.2	<i>A more effective delivery process</i>	37
5.3.3	<i>The merits of standard rates against actual rates</i>	37
5.3.4	<i>Maintaining SMI</i>	38
5.3.5	<i>Rethinking the two year JSA/SMI limit</i>	38
5.3.6	<i>The relationship of SMI to contemporary mortgage and housing markets</i>	38
5.3.7	<i>Pensioners in receipt of SMI</i>	39
5.3.8	<i>Delivering a soft exit from homeownership</i>	39
	Appendix A Research methodology	41
	References	42

List of tables

Table 2.1	Interest rates by type of mortgage in January 2009 and September 2010	12
Table 2.2	Average mortgage interest rates of SMI claimants by type of mortgage.....	12

Acknowledgements

The authors are grateful to the lenders, money advisers, Jobcentre Plus staff and key policy stakeholders who gave time to be interviewed. The support of Andy Brittan and Zoe Uren at the Department for Work and Pensions (DWP) and their colleagues who commented on the draft report is also gratefully acknowledged.

The Authors

Janet Ford is Emeritus Professor at the Centre for Housing Policy, University of York. She has a long-standing interest in home-ownership and has undertaken a number of studies examining the effectiveness of the state and private safety-nets for owner occupiers.

Alison Wallace is Research Fellow in the Centre for Housing Policy, University of York. She has recently been involved in studies examining: the intermediate housing market for low income home owners; lender forbearance; and an evaluation of the Mortgage Recue Scheme and Homeowners Support. She is currently undertaking research on the extent and nature of Assisted Voluntary Sales.

Moira Munro is a Professor of Public Policy at Urban Studies, Glasgow University. She has a long-standing interest in housing finance and policy towards owner occupation.

Nigel Sprigings is Lecturer in Housing Studies at Urban Studies, Glasgow University. His research interests include social housing management, homelessness and more recently the aspects of the private rented sector.

Professor Susan J Smith is currently the Mistress of Girton. She has had a distinguished career both as a social geographer and in the interdisciplinary world of housing studies. Her current research focuses on the housing economy; house prices, mortgage debt and financial risk.

Summary

The study

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. The aim was to assist more homeowners, and sooner, and thereby prevent possessions. The research, commissioned by the Department for Work and Pensions (DWP), explored the responses of lenders, money advisers, 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). 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 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 standard interest rate was reduced to 3.63 per cent.

The timing of the research made it possible to consider the reduction of the SMI interest rate in October 2010 and the early impact of the ending of the two year SMI claim period for those who first received JSA in January 2009. The research 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 (including both mainstream and specialist lenders), six money advice workers, six Jobcentre Plus staff with experience of identifying and processing SMI applications, 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. In some cases a significant gap between the SIR and the borrower's actual mortgage rate allowed them to accumulate a buffer.
- 2 Lenders reported that the SMI changes underpinned their 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.
- 3 Money advisers and key stakeholders noted that the temporary arrangements were beneficial to borrowers and they reported a greater likelihood that forbearance could be agreed with lenders. Money advisers also reported a lack of knowledge among many new claimants with respect to SMI.

2 Summary

- 4 SMI was not equally effective across all borrowers. Those with higher rate loans, older mortgages (so a greater proportion of the payment was for capital repayments), 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.
- 5 The SMI changes were implemented in a context of falling interest rates and this 'added value' to SMI to a very significant extent. In this context, while SMI might not always pay in full, it did pay something and kept losses off the lenders' balance sheet.
- 6 There was no evidence that the introduction of a two-year limit for new JSA claimants had any impact on the way lenders responded to borrowers in arrears in 2009. Money advisers reported that borrowers were unaware of this limitation. Lenders were also unable to identify which borrowers in receipt of SMI might be affected by this constraint. Lenders 'parked' the issue at this stage.
- 7 Although eligibility for SMI can often follow straightforwardly from the initial claim for out-of-work benefits, the effectiveness of SMI can be constrained by shortcomings in the assessment and administrative processes associated with SMI. 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. These factors can act to delay claims. Incomplete documentation from borrowers can result in them not achieving the correct award of SMI in relation to potentially eligible interest. Delayed claims may result in further financial costs to borrowers, including arrears. Many of these shortcomings were exacerbated by the rapid increase in workload within Jobcentre Plus in early 2009.
- 8 Money advisers noted that lenders were not always willing, or able, to convert capital and interest mortgages to interest only mortgages. The effectiveness of SMI was reduced in these situations as the borrower still had to meet capital payments to preclude arrears. Further, while SMI may be effective in its own terms, if a borrower has significant non-qualifying loans on which arrears mount, the receipt of SMI will not preclude arrears on the mortgage(s) as a whole which, as a result, may lead to possession.
- 9 Overall, however, the 2009 changes resulted in more people being assisted, more fully and sooner. Borrowers have 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.
10. Lenders were very concerned by the October 2010 reduction in the SIR to 3.63 per cent. They recognised that all the temporary measures would not, or should not, necessarily continue, but noted that the SIR reduction in one step was too steep. The time scale for the introduction of the change gave borrowers and lenders little time to plan for reduced help. 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 of lenders 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.
- 11 Most lenders reported that they were now seeing an increase in the number of borrowers with shortfalls on their payments. They also noted that the full impact of the reduction in the SIR was in some cases currently 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.

- 12 Lenders are increasingly prepared to re-consider their forbearance approach as arrears mount. There is a range of responses, but the growing shortfalls and the continuing sluggish economic conditions are facilitating a change in sentiment and, potentially, a change in forbearance practices. Tighter regulatory requirements (especially on capital) add to the pressure on lenders for some re-evaluation of their approach.
- 13 Money advisers and key stakeholders confirmed that they were aware of this shift in sentiment with some lenders moving faster than others. Money advisers reported that it was becoming more difficult to negotiate forbearance agreements on behalf of their clients with some lenders. They noted that there were now SMI recipients coming through to the courts for possession, although not yet in large numbers.
- 14 Lenders, money advisers, Jobcentre Plus staff and key stakeholders all expressed concerns 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 their timing gave borrowers little time to plan for a significant change in their financial circumstances.
- 15 The impact of the two-year limit on SMI for new JSA recipients from January 2009 is now materialising. Lenders were becoming aware of a small number of cases; money advisers to a greater extent. Both lenders and money advisers noted that borrowers were poorly informed about the potential ending of their SMI. While it is still very early to be clear about the likely scale of claims ended and lenders' responses, lenders, money advisers and key stakeholders noted that after two years forbearance, and with borrowers still without employment (and particularly if not eligible for mortgage rescue), it was likely that there was little scope for any action other than possession.

Summary of key findings

- 16 Lenders, money advisers and key stakeholders interviewed confirmed that the temporary changes introduced in January 2009 were highly beneficial in terms of preventing possessions. The arrangements delivered help swiftly and effectively to borrowers and enabled lenders and money advisers to support borrowers effectively. They are equally clear that the reduction in the SIR introduced in October 2010 reverses many of the previous benefits. Lenders highlighted the already noticeable increases in shortfall payments and money advisers noted that more lenders were now less able or less willing to forbear. All respondents perceived that where borrowers' receipt of SMI came to an end after two years (particularly in the absence of employment) it was unlikely that lenders would be able to support them further to sustain their homeownership.

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 continues to be 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

Jobcentre Plus faced some difficulties in implementing the changes to SMI in the time frame available, and particularly in respect of the October 2010 change. This change was notified to claimants late in the day and via letters that were not always clear to them. There were additional queries to Jobcentre Plus as a result. Although the process is working better now, there needs to be consideration of how changes are notified as well as a focus on other problems identified in relation to the delivery of SMI, for example, the failure to identify a proportion of potential SMI claimants at the first claims stage.

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 giving rise to inequitable treatment and is likely to disadvantage the most vulnerable homeowners many of whom are concentrated among the 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 would be cumbersome and could encourage lenders to raise rates. A critical issue is finding the level of SIR that minimises 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. Overall, it has provided considerable support to borrowers and the housing market. Cutting SMI provision is already proving problematic for some borrowers and 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 for the foreseeable future the proportion of JSA claimants unable to achieve work in the time-frame may increase. The timing of the withdrawal of this support looks unfortunate and counterproductive if possession follows. Some consideration should be given to minimising any further financial difficulty for borrowers as they exit the tenure. More thought also 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. Given the changing context within which mortgages are offered and held, 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 may take some time to become apparent. However, all interview participants concurred that there will be an increase in the number of borrowers for whom homeownership is no longer sustainable. Lenders, advisers and key players noted the likely rise in possessions.

There have been good reasons to date why policy has been directed towards the prevention of possession, not least the objectives of limiting homelessness, giving borrowers the best chance of overcoming 'temporary' difficulties and so retaining an asset, and a recognition of the social, emotional and financial costs of possession. The only alternative to possession has been mortgage rescue which has been an attractive option, but eligibility is restricted to vulnerable households, and the price for MRS properties has been reduced recently. Medium-term funding for MRS is uncertain.

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, for example paying some or all of the legal fees or providing advice on marketing and valuation. Some lenders are developing this approach, but relatively little is documented as yet about the extent or nature of AVS, or the exact circumstances in which lenders offer this option;
- 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) with SMI seen as an investment that would return funds to the public purse on the sale of the property. Compared to the costs of Housing Benefit this could be a cost effective housing option.

1 Introduction

1.1 Background

Support for Mortgage Interest (SMI) is a component of certain income-related benefits and is not a benefit in its own right. It is available to claimants who qualify for specified benefits (Income Support (IS), Employment and Support Allowance (ESA), Jobseeker's Allowance (JSA) and Pension Credit (PC)). There have been a number of amendments to the scheme, starting in 1987, with a key shift in the structure of the benefit in 1995. From then, mortgage borrowers in receipt of IS (and, when introduced, JSA and ESA) had to wait 39 weeks to receive full eligible interest (though certain claimants could receive help after 26 weeks with 50 per cent payable from 8 weeks), SMI was paid at a standard interest rate (SIR) and eligible interest was paid on (up to) the first £100,000 of any mortgage. Mortgagors of pension age are not required to serve a waiting period.

Assessment of the effectiveness of SMI over the period from the late 1980s showed that its role in preventing arrears was considerable in the early 1990s (Ford and Wilcox, 1992). Post-1995 it was less effective as the structure of the changes introduced generated arrears due to the lengthened wait period and an SIR that was often below the actual mortgage rate payable (Kempson *et al.*, 1999). Further, increased competition to lend and more flexible products supported frequent re-mortgaging, including equity withdrawal, which resulted in claimants sometimes having a portion of their loan(s) that did not qualify for SMI which covers only 'allowable' housing expenditure.

Benign economic and labour market conditions in the early 2000s reduced the number of SMI claimants, while the changes to the benefit introduced in 1995 limited expenditure on SMI (Wilcox, 2010). However, from 2004, mortgage arrears among all borrowers started to rise again, albeit slowly, but then accelerated as significant difficulties began to emerge in the housing market in mid 2008. The forecast was for rising possessions (CML, 2008), not least due to rising unemployment and the lack of available credit to borrowers for debt consolidation via re-mortgaging.

Faced with deteriorating conditions in the credit and housing markets, and recessionary conditions, the Government responded quickly (and more quickly than had been the case in the previous recession) and announced a series of measures to support the housing market and to limit possessions, which were implemented from January 2009 onwards. These included a Mortgage Rescue Scheme (MRS), Homeowners Mortgage Support (HMS), increased funding for the provision of advice services, significant publicity about the help available to borrowers and changes to the terms and conditions of SMI. The agreement of lenders to do all they could to increase forbearance was also signalled. In addition, the Civil Justice Council introduced the Pre-Action Protocol for Mortgage Arrears to ensure lenders only used possession as a last resort.

Under the new arrangements for SMI, eligible working-age mortgagors would receive help after a shorter, 13 week waiting period and available help was extended to pay the interest on loans up to a maximum of £200,000 (from the previous limit of £100,000). The scheme also introduced a maximum SMI payment period of two years for new JSA claimants¹. SMI was paid to all at an SIR: despite the general decline in interest rates it was maintained at 6.08 per cent – relatively high in relation to the base rate of 1.5 per cent in January 2009 and even higher in relation to the 0.5 per cent base rate that has been in force since March 2009.

¹ This could be either a continuous period or a maximum of two year claims if there were repeat linked claims.

The policy aims of this package of measures were:

- to provide help earlier, through a shorter waiting period;
- to reach more people at a time of economic uncertainty;
- thereby, to minimise repossessions.

Subsequently, the emergency budget in June 2010 announced that the SIR would be reduced and from October 2010 it has been based on the Bank of England published average mortgage interest rate (currently 3.63 per cent, the rate published by the Bank on 31 August 2010).

1.2 Research into the effectiveness of the 2009 changes to SMI

In spring 2010, the Department of Work and Pensions (DWP) commissioned research to explore the effectiveness of the changes to SMI. The research had two phases.

- Phase 1 explored the issues from the perspective of borrowers in receipt of JSA and ESA who from January 2009 became eligible for SMI at 13 weeks, using a survey of claimants. A report on Phase 1 was published in November 2010 (Munro *et al.*, 2010).
- Phase 2 was commissioned in January 2011 and focuses on the responses of lenders, money advisers, Jobcentre Plus and key stakeholders to the January 2009 changes, and the impact of these responses on the effectiveness of SMI. The timing of Phase 2 has also allowed the research to consider two further issues; the reduction in the SIR which was implemented in October 2010 and the impact of ending the receipt of SMI after two years that affects JSA claims made after 5 January 2009 (and which run the full two years).² This report presents the findings from Phase 2.

1.2.1 Phase 2: rationale and scope

The effectiveness of SMI for borrowers, and the housing market, is dependent in part on the responses of lenders, advisers and Jobcentre Plus staff to the changes, each of whom have particular roles, concerns and interests. Lenders for example, can support or undermine the policy intent depending on their willingness to forbear with respect to arrears. For example, potentially, they can change a mortgage from requiring both capital and interest payments to an interest only arrangement and so maximise the impact SMI can have in preventing or limiting arrears. Advice agencies have a role to play in ensuring borrowers know of any eligibility for SMI, as do Jobcentre Plus staff. Along with identifying cases where SMI is payable, Jobcentre Plus staff are also responsible for assessing claims and for the overall administration of SMI for working-age claimants.

Phase 2, therefore, considered the approach and activities of four groups of actors; lenders, money advisers (in organisations such as Citizen Advice Bureaux, housing charities, local authorities), Jobcentre Plus staff and key policy and industry stakeholders and the impact their actions had on the effectiveness of SMI. In-depth qualitative interviews were undertaken with nine lenders including both prime and sub-prime lenders, six advice workers in different agencies and parts of the country, staff in six Jobcentre Plus offices with experience of identifying and processing SMI applications³, and three key stakeholders. Most interviews were by telephone, usually of between 45 and 60 minutes.

² There are two exceptions. Some claims made after 5 January 2009 were linked to previous claims and so paid under the 'old' rules. Some JSA claims made before 5 January 2009 but in the qualifying period at that date qualified for the new rules.

³ In most offices one person was interviewed, but in a small number of offices two staff took part in the interview.

The interviews were written up and the notes used for analysis. All information was provided on an anonymised basis.

The research was qualitative, and the analysis is based on a relatively small number of interviews, not randomly selected, and used a topic guide to steer the interviews rather than a structured questionnaire. This approach provides the opportunity for the researchers to explore a range of issues in detail, and to understand why and how participants are viewing and responding to complex issues in a changing context. The potential limitations of the approach have to be acknowledged however. For example, findings are inevitably indicative and cannot provide concrete information on the scale of the trends identified or where respondents are selected purposively there is a risk of introducing bias in terms of the range of experience reported. Sometimes the approach is highly exploratory seeking to identify the key themes for a larger piece of research etc. A number of factors provide confidence that in this case the research has minimised these factors. For example, Phase 1, which was based on systematically collected data from claimants, helped to shape the focus of Phase 2 by identifying key issues that needed further exploration. In addition, the selection of interviews was designed to ensure that all segments of the mortgage market were included, and that advisers and Jobcentre Plus staff were drawn from a number of different geographical and housing market areas. Appendix A provides further details of the research methodology.

1.3 Structure of the report

Chapter 2 considers the range of responses to the 2009 changes and their impact on lenders, advice workers and Jobcentre Plus. It details a range of positive outcomes associated with the changes, including benefits for borrowers, but also in some cases for other parties too.

Notwithstanding that SMI delivered many benefits, there were a number of factors that constrained its effectiveness and Chapter 3 considers these limiting factors.

Chapter 4 considers the reduction in the SIR that was implemented in October 2010, and its impact on lenders, advisers and Jobcentre Plus. Respondents were able to provide information on the outturn of this change both for themselves but also for borrowers. In addition, Chapter 4 considers the impact of the two-year fixed period for the receipt of SMI applied to new JSA claimants from January 2009. At the point of interviewing the first cases of borrowers losing benefit were expected, and although the numbers are currently very small (and the flow uncertain) Chapter 4 considers the assessments and expectations of lenders, advisers and key policy stakeholders in response to this development.

Chapter 5 draws the findings of the study together and comments on their relationship to the Phase 1 results. Some emerging issues are identified.

2 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus

2.1 Introduction

As recessionary conditions took hold in the UK in 2008, a number of key representative organisations indicated their concerns about impending arrears and possessions to government. Interviews with key stakeholders noted that, to varying degrees, they lobbied for:

- an increase in the Support for Mortgage Interest (SMI) capital limit;
- a shorter waiting period;
- the SMI interest rate to reflect a borrower's actual mortgage interest rate;
- a mortgage rescue scheme that would enable borrowers to remain in their properties but as tenants;
- lenders to be required to offer greater forbearance; and
- the introduction of a mortgage pre-action protocol.

To a greater extent than previously, stakeholder organisations worked together to create a strong message about the need for intervention, and to benefit from the growing press and political pressure also pressing for action from government.

Two of the three stakeholders interviewed and none of the lenders had any part in the development of the specific proposals that were brought forward (outlined in Chapter 1) and announced by the Prime Minister in November 2008 as part of the pre-budget announcements. Stakeholders, and some lenders, noted that government had had to act quickly in response to the evidence of rising possessions and speed was one factor in determining the measures that were brought forward. Respondents perceived that government was mindful of the fact that the responses to the late 1980s and early 1990s recession had come too late.

2.2 The response to the 2009 changes and to SMI in particular

Previous studies have reported in some detail the responses of lenders, advisers and stakeholders to the interventions. Those studies have, however, focused primarily on the Department of Communities and Local Government schemes—the MRS and Home Owners Support (Wilcox *et al.*, 2010), and lender forbearance (Wallace and Ford, 2010), but offered little consideration of SMI. In contrast, the study reported here focuses on the responses to, and effectiveness of, the SMI changes.

Some of the changes introduced applied to all borrowers (the Standard Interest Rate (SIR)). The shortening of the wait period affected all working age claimants of Jobseeker's Allowance (JSA), Income Support (IS) and Employment and Support Allowance (ESA). The new two-year rule affected

10 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus

only working age JSA claimants⁴. The increased capital limit only applied to those working age claimants who claimed from 5 January 2009 or who were in the waiting period for SMI on 4 January 2009. The changes would increase the number of JSA claimants in receipt of SMI by paying it earlier (taking them out of the wait period at 13 rather than 39 weeks). For other claimant groups able at that time to receive 50 per cent SMI payment after an eight-week wait period and until week 26 (and thereafter 100 per cent), they would receive 100 per cent eligible SMI sooner at 13 weeks.

The interviews show the significant welcome and support for almost all the SMI amendments. Lenders, advisers and key players noted the obvious direct benefits for borrowers, but also the way in which SMI now changed the context in which they interacted with borrowers, and with each other. Only in respect of the two-year limit for new JSA claimants was there significant disquiet.

2.2.1 Impact of the 13-week wait period

All nine lenders interviewed noted the problems that the previous 39 week wait period had caused and recognised the benefit of the new 13-week period. As a result of this change they received payment sooner and all lenders reported that this increased their willingness and ability to forbear. The risks of forbearance were significantly reduced for lenders as earlier payment prevented or reduced the level of arrears, and increased the likelihood that borrowers would be able to repay. The quotations below from five different lenders make these points.

'The old waiting period of 39 weeks was just unrealistic. It [the reduced waiting period] was a move the Government had to make as lenders wouldn't wait that long. With 13 weeks a lender is going to forbear as direct payment of interest is going to get paid sooner.'

'Moving to 13 weeks was great news-exceptionally handy as it calmed borrowers' anxieties, it was a shorter time and there is not the chance to build up unmanageable arrears.'

'...it gives the lender more incentives to engage and forbear. The 39 weeks [along with] advances of over £100,000 did not provide many positives for lenders to assist if the circumstances were that the borrower was out of work. It was unlikely that they had spare cash even for interest during this period. The change gives the lender something to work with, borrowers don't have nine months of arrears on the account before SMI is paid, and the lender does not have the costs of a non-performing loan.'

'Borrowers welcomed the short time lag in which to get the situation resolved, it's had a massive impact.'

'The 39 weeks was a terrifically long time to try and get something. The shorter time meant that there has been less discussion, but we knew we'd get something [soon]. We could ask for concessionary payments for a short time and move people on to interest only mortgages. It very much helped us forbear.'

Advisers and key stakeholders reinforced the view that the 13 week wait period had made a critical contribution.

'...the shortening of the waiting period is simple and positive.'

(Key player)

'The greatest positive impact has been from the reduction in the waiting period as it gave lenders confidence in the system and they were more willing to forbear.'

(Adviser)

⁴ Excluding borrowers on IS and ESA who are transferred to JSA within 12 weeks of the IS/ESA claim ending

The interviews considered the range of ways lenders were forbearing towards borrowers on SMI once the 13 week wait period was implemented. Lender and adviser interviews noted that lenders typically considered one or more of:

- Changing the mortgage from capital and repayment to interest only.
- Allowing concessionary payments where there was a shortfall on the interest payment or an inability to meet capital payments.
- Allowing any arrears build up in the 13-week wait period ‘to sit there’ without seeking their repayment at this stage.
- Withholding from any application for possession or from activating suspended orders that had been granted previously.

In principle, the most beneficial position for borrowers on SMI is an interest-only mortgage. Assuming the entire mortgage is an ‘eligible’ loan, then full interest is paid and arrears prevented. Where interest-only mortgages are not in place, SMI is more effective the more recent the mortgage as in these cases the bulk of the monthly payment is interest with capital constituting a small part. As mortgages age, the balance shifts to capital payments.

Lenders reported that they frequently considered and implemented interest-only mortgages. Advisers perceived the picture to be more varied but recognised that they were seeing only a particular portion of borrowers in arrears, typically those with more difficult circumstances who already had arrears. One adviser noted that change, although often achieved, was not automatic:

‘Most lenders will revert to [an] interest only [mortgage] if requested.’

While another said:

‘There is still a process of negotiating to go from repayment mortgage to interest only and this depends on case by case circumstances.’

Overall, lenders were seen as responsive and willing to forbear by shifting borrowers to interest-only mortgages. In a small number of cases advisers noted that this step could be resisted and these limitations on the effectiveness of SMI are discussed in Chapter 3.

The 13-wait period was a significant change, with direct positive impact. It reassured borrowers, precluded arrears in many cases, ensured that where arrears developed they did not mount excessively, provided lenders with greater certainty, met some if not all the payments due to them and shaped their ability to consider a wider range of forbearance. Advisers found it easier to negotiate forbearance agreements.

2.2.2 The Standard Interest Rate

In January 2009, despite falling interest rates, the Department for Work and Pensions (DWP) confirmed that the SIR for SMI would remain at 6.08 per cent. While not all mortgage rates now fell below this level most did and where this was the case SMI recipients (and, therefore, lenders) received a sum higher than the monthly interest payment. The SMI claimants least likely to benefit were those with mortgages from sub-prime lenders where often the assessment of the risks they posed led to higher interest rates being imposed. These rates could exceed the SIR.

Table 2.1 indicates the average rates on different kinds of mortgages in January 2009 for all borrowers. The range of interest rates within any one category is however, broad, and loans made by the sub-prime sector can be significantly above the average. For those borrowers with standard variable rates below the SIR and for borrowers on tracker mortgages the potential benefits should

12 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus

they have to claim SMI became even more substantial, as they did for lenders, as base rates fell to 0.5 per cent in March 2009 and remained there. The extent of the potential benefit is indicated by the average mortgage rates that pertained in September 2010, (just before the SIR was reduced) which are also shown in Table 2.1.

Table 2.1 Interest rates by type of mortgage in January 2009 and September 2010

Average % interest rates, by type of mortgage	Tracker	5 year fixed	2 year discounted	Standard variable
January 2009	4.51	4.49	4.08	4.73
September 2010	3.56	5.04	2.98	3.93

Source: Bank of England.

Table 2.2 considers borrowers already in receipt of SMI and shows the average interest rate by type of mortgage in a sample of 6,000 claimants (of whom 50 per cent could not provide loan information). Table 2.2 is not directly comparable with Table 2.1, not least because of interest rate changes on some products between January and November 2009. Against the SIR of 6.08 per cent, the average rate for all types of mortgage among SMI claimants was below the SIR. Again, the spread of mortgage rates around the average can be considerable and particularly among the 32 per cent of claimants on fixed term/fixed rate mortgages, where the average approached six per cent, some interest rates would be considerably in excess of the 6.08 per cent. Assessing the impact of the 6.08 per cent SIR DWP noted that: 'At the SIR of 6.08 we estimate that 92 per cent of SMI customers will receive awards in excess of their eligible mortgage interest outgoings. However, customers in this position do not necessarily receive SMI payment in excess of full housing costs where part of the mortgage is ineligible' (DWP, 2010b).

Table 2.2 Average mortgage interest rates of SMI claimants by type of mortgage

Average % interest rate by type of mortgage	Tracker	Fixed (all periods)	Other variable	All
November 2009	2.1	5.70	4.2	3.8
Proportion of mortgages held by SMI customers	28	32	40	100

Source: DWP, 2010.

There were a number of outcomes:

- The prevention or reduction of arrears as borrowers used 'excess' interest to meet interest on non-qualifying loans or parts of loans.
- The erosion of arrears built up in the 13-week wait period (or in a longer period for JSA claimants who were some way into the 39 week period in January 2009).
- A potential contribution to capital payments (after arrears are eroded).
- All payments met and the accumulation of a buffer.

Where there was a prevention, reduction or 'holding stable' of arrears as a result of the beneficial SIR this allowed lenders to let cases 'ride' with limited action on their part. Initially, however, lenders

faced some uncertainty about how payments in excess of the actual interest due were to be treated with some customers in the most favourable positions wishing to access the excess. New legislation was required to ensure that lenders retained all the SMI interest against the mortgage account (SI 2010 No.796).

As a result, lenders who might have been minded to pursue aggressive repayment demands had less reason to do so and they were also constrained in applications to the court for possession by the requirements of the mortgage pre-action protocol under which they had to demonstrate that all forbearance avenues had been explored.

Talking about the period January 2009-October 2010, advisers noted that lenders had been open to considering a wide range of forbearance and willing to engage with the advice services to agree concessionary payment plans etc. For example:

'Lenders have been very happy with SMI even where there has been a slight shortfall.'

'...lenders were very willing to accept just [the SMI] payment, a bit of a shortfall [was] OK and they were not pushing for possession.'

'Lenders have supported the SMI system, but it has suited them to support the measures, they have sat back with 'manageable' arrears not least because of low interest rates and above average SMI.'

Lenders too noted the beneficial outcomes. One national lender reported that in October 2010 (before the reduction in the SIR) 70 per cent of their borrowers who were claiming SMI were in credit, although it was not possible to know whether they were IS, ESA, JSA claimants or pensioners. Another lender noted that, 75 per cent of their SMI cases had an interest rate below the 6.08 level and so were making inroads either into any arrears and/or to their capital payments. In a third case more than 90 per cent of SMI borrowers were paying in full or in credit, most of whom had mortgage rates below the SIR of 6.08 per cent. A fourth lender with a significant number of SMI claimants estimated that only 15 per cent of claimant accounts were in arrears. This account of the impact of the SIR on borrowers' payments is in line with the Phase 1 survey of borrowers claiming SMI where only a small minority had arrears.

Further, lenders noted how the benefits of the SIR at 6.08 per cent continued to be felt even after the SIR was reduced in October 2010 (see Chapter 4 for further details). Indicating that in his assessment the majority of borrowers had had interest rates below the pre October 2010 SIR one lender said:

'...many accounts built up a credit...by accident rather than thought out...this means that [the credit on the account] is now acting as a buffer...[against the impact of the new SIR].'

It, therefore, seems reasonable to conclude that the SIR of 6.08 per cent has been of very significant benefit. However, it is not possible to say whether SMI claimant borrowers without arrears are in this position solely as a result of SMI, or because alongside SMI other factors enabled them to make full payments (for example, drawing on savings). The Phase 1 report noted that borrowers did draw on their savings/redundancy payments or the very small part-time earnings of other household members. In these cases, the enhanced amounts of SMI have clearly facilitated borrowers in being able to make other payments.

The position for lenders and borrowers where loans were fixed rate loans above the 6.08 per cent or high Standard Variable Rate (SVR), typically in the sub-prime sector, was not so beneficial. One sub-prime lender acknowledged that the rate overall was generous and that the high street lender might think 'very nice, thank you very much, my rates are covered and there's additional income, but it's not so great where higher rates and vulnerabilities are concerned.' This respondent went on to note that people were charged a higher rate for the reason that they were more risky.

14 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus

2.2.3 Higher capital values

The 2008 housing market recession followed a period of rapid house price inflation. Average prices had risen from £65,644 in 1995 to £204,000 in 2008 (CLG, Table 502). While the distribution of mortgages is wide, many interviewees argued that the SMI capital limit of £100,000 was now an inadequate reflection of the market.

'...the cap at £100,000 didn't bear resemblance to house prices or loan to values.'

(Stakeholder)

Key stakeholder organisations had for some time lobbied for change in this area, including in one case a suggestion that the capital value might increase annually in line with inflation.

Lenders, therefore, welcomed the change to £200,000⁵, recognising that in more cases they would now receive full interest and in other cases a higher proportion of the interest due. It was not possible however, to establish from lenders or other respondents how many additional cases had been assisted.

The impact of the increased capital threshold reinforced the basis for forbearance where necessary and increased the percentage of their claimants who were paying in full and potentially increasing their ability to meet any capital requirements. Forbearance was possible in an increased number of cases. For borrowers, this safeguarded their homes against the costs of arrears and possession. Only one of the lenders interviewed suggested that there had been little impact from raising the capital threshold.

2.2.4 The two-year limit on SMI for new JSA claimants

The inclusion of a time limited payment for borrowers claiming JSA after 5 January 2009 marked a clear departure from the previous principle that had seen SMI paid for the duration of receipt of a qualifying benefit. One lender described the changes as 'radical.' For many interviewees, their immediate responses in 2009 and the assessment of the potential impact were influenced by the fact that the implications for borrowers and lenders were some way ahead and that JSA claimants made up a small proportion of all SMI claimants. In some cases this allowed the issue to be 'parked.'

Lenders, where they commented at all, indicated that their perception was that the two year limit addressed the work disincentives agenda, not issues of support for mortgagors and the housing market.

'It's a political decision, focusing on people getting work and not getting benefit.'

(Lender)

Those that did look ahead recognised the potential issues:

'...understand the reasons behind the two year limit but unsure of its impact but guess it won't be good.'

(Key stakeholder)

Another lender noted that if the alternative was not offering SMI to job seekers then the two-year limit was preferable but it was not a positive step.

⁵ This represented a medium priced property and a loan at 95 per cent of value (DWP, 2009). The introduction of the £100k capital limit in 1995 provided headroom of about a third over the average house price at that time. The £200k limit provides less headroom. In January 2011 the average house price was £208,552 (DCLG, 2011).

Some stakeholder organisations and debt advisers also perceived the measure as influenced by a concern among policy makers that SMI might constitute a work disincentive, despite there being no clear evidence to that effect. Occasionally, stakeholders and money advisers were more forthright about the potential damage of the two-year limit both to borrowers and the state. The issue was more to the fore for advisers, as they found that on a first interview some of their clients had no information or knowledge of SMI *per se* and none had any knowledge of the time limited nature of SMI and this had to be explained to them. Advisers noted that if JSA borrowers lost SMI after two years it was hard to see how lenders could continue to forbear, and how possession could be avoided, not least because after two years unemployment the prospects of work were in all probability very limited. The two years was seen as arbitrary – but perhaps based on a belief that the economy would be out of recession by then. One stakeholder commented that potentially the two year limit would:

‘...probably end up costing the state more [than retaining claimants on benefit] by the time all the financial and social costs of repossession are taken into account.’

It is important, however, to situate the above perception that the two year limit was a work incentive measure in the context of the Phase 1 report, which noted ‘The analysis reveals no indication of any work disincentive amongst respondents-almost all express a keen desire to work’ (Munro *et al.*, 2010). The DWP Impact Assessment ahead of the introduction of the measure likewise showed just how few JSA claimants remain unemployed for any length of time (based on February 2008 data). Only three per cent of JSA claimants (in total, not just those in receipt of SMI) were unemployed for over 104 weeks (two years). 74 per cent returned to employment in up to 26 weeks (DWP, 2009, Table 5.5).

At the time of the research, the two-year period for JSA/SMI claims which started in January 2009 was coming to an end. Chapter 4 considers the emerging impact as the issue rises up the lenders’ and advisers’ agenda.

2.3 Implementing the SMI changes

Jobcentre Plus is responsible for the assessment and implementation of SMI for working-age people. This is a benefit component whose purpose – to meet eligible housing costs – requires a complex design. First, it requires there to be a qualifying benefit in place (JSA, IS, ESA, PC); second its assessment requires detailed household financial information, particularly about the employment of other household members, but also about the receipt of mortgage costs from any claim on a Mortgage Payment Protection Insurance policy. Thirdly, qualifying interest relates only to loans for ‘eligible’ purposes, i.e. to support the original home purchase or specified necessary repairs and improvements to the home⁶. As the mortgage market has provided re-mortgaging opportunities, a growing proportion of mortgagors have used the opportunity (alongside rising equity) to withdraw equity for non-housing purposes such as holidays or non-housing capital expenditure. Interest on loans (or parts of loans) for this type of expenditure is not eligible for SMI (which was designed as, and has remained, provision for specified housing costs) and so a process is in place that requires claimants to provide documentation of the purpose of any and each mortgage/remortgage in force, and their lender(s) to confirm the information.

⁶ For a discussion of the latest regulation on eligible costs see: www.legislation.gov.uk/ukxi/1987/1967/schedule/3/made

16 The impact of 2009 SMI changes for lenders, money advisers, key stakeholders and Jobcentre Plus

Jobcentre Plus staff involved with SMI perceived the 2009 changes as largely straightforward and handled well although there was some confusion relating to the transitional waiting period for some categories of SMI claimant that took some time to clarify. Otherwise, most of the initial problems resulted from the sheer quantity of cases. This was a result of the coincidence of a rising trend of new claims and the need to assess existing claimants in the 39 week waiting period all of whom had to be reviewed in respect of both the waiting time and the new capital limit of £200,000k. Interviewees noted that as a result throughout 2009 there were delays in payment and complaints.

'Now we're up to date but from January 2009- through to the end of 2009 it was absolutely horrendous. No one was getting anything on time, but during 2010 it settled.'

(Jobcentre Plus staff)

The 2009 changes were both agreed and introduced rapidly, with benefits for borrowers and lenders, but inevitably leaving little time for Jobcentre Plus teams to gear up or receive training. The changes in 2009 were notified by bulletins.

'The training was not enough during 2009. Surprised if everyone did it right in 2009...they didn't.'

(Jobcentre Plus staff)

Despite teething issues, advisers noted that they could usually sort things out with Jobcentre Plus (although see Chapter 3) and that the decisions they made on eligible costs, which could require discretion, were fair and well managed.

'Once Jobcentre Plus have reached the point that eligibility is established [they] are as reasonable as they can be.'

(Adviser)

Lenders had a more varied assessment of the effectiveness and cooperation of Jobcentre Plus. Overall, some lenders noted that the processes associated with SMI claims were reasonable but the administration and implementation of changes produced some constraints on the effectiveness of SMI and are discussed in Chapter 3.

2.4 Summary and conclusions: the effectiveness of the 2009 SMI changes

There was unanimity among the various different parties interviewed that after January 2009 SMI was the core component in assisting borrowers and limiting possessions. Mortgage Rescue and Homeowners Mortgage Support filled gaps where SMI did not provide support or where support failed to be adequate.

The extent to which the 2009 SMI changes can be assessed as effective depends on their impact on the policy goals. In Chapter 1, the policy aims of this package of measures were identified as:

- to provide help earlier, through a shorter waiting period;
- to reach more people at a time of economic uncertainty;
- thereby, to minimise repossessions.

There is clear public evidence that SMI has made a positive impact on the first two policy goals. Despite some teething problems, SMI is paid sooner, and, as a result, it drew in borrowers some way into the 39 week waiting period, so assisting a larger proportion of mortgagor claimants than was the case in 2008. The reduction of the waiting time from 39 to 13 weeks by definition delivers help to those in difficult labour market circumstances. The additional resources for advice services provided by government, and by lenders themselves in some cases, has increased the number of people borrowers can see, and who can direct them to the range of schemes available to help them – including SMI.

In respect of preventing possessions, because SMI may not meet all the interest due on a mortgage (only the interest on eligible loans or eligible parts of loans), and does not meet capital payments or any costs associated with the management of arrears, there is the potential for SMI claimants to have payment shortfalls and costs that accumulate as arrears. SMI *per se* does not automatically prevent arrears and possession. Thus a key indicator of the effectiveness of SMI is the extent to which the benefit held down arrears. The evidence presented above noted that the SIR at which SMI was paid between January 2009 and October 2010, along with the increase to the capital limit, did indeed prevent some borrowers from developing arrears and in other cases reduced the level of arrears. In some cases, it allowed borrowers to ‘overpay’ and thereby contribute to any capital payments required. Further, as a result of the nature of the SMI regime, lenders were more willing to forbear on any outstanding costs and to limit applications for possession.

SMI was not equally effective across borrowers. In particular, those with higher rate loans, older mortgages, mortgages above the eligible capital limit, or who had extensive equity withdrawal and ineligible costs (or costs they could not prove to be eligible) could still face a significant gap between payments due and SMI receipts.

The SMI changes were implemented in a context of falling interest rates and this ‘added value’ to SMI to a very significant extent. House prices were also falling, and the number of borrowers in negative equity was growing and both these factors constrained lenders’ options. In this context, while SMI might not always pay in full, it did pay something and kept losses off the balance sheet.

There was no evidence that the introduction of a two-year limit for new JSA claimants had any impact on the way lenders responded to borrowers in 2009.

There were, however, a range of factors identified by interviewees that either reduced the impact of SMI or made the experience of claiming SMI more difficult than it could have been, or reduced the extent of the indirect benefits that SMI delivered. Chapter 3 explores some of the key limitations on the effective implementation of SMI.

3 Limitations on the effectiveness of SMI

3.1 Introduction

This chapter considers a number of different types of limitations associated with Support for Mortgage Interest (SMI). Some of these emanate from the SMI administrative and implementation process, while others emanate from the context in which SMI is implemented which may limit the impact of SMI, even where SMI is paying full eligible costs.

In discussing these constraints and limitations, it is only possible to indicate the range of factors that impinge on the effectiveness of SMI, and the ways in which they might affect the provision of SMI or its impact. The qualitative data available to us does not provide any systematic administrative or survey data on the frequency with which these constraints occur or the number of borrowers they affect.

3.2 Implementing the SMI changes; the administrative process

It was noted in Chapter 2 that, for good reason, the structure of SMI is complex. This has implications for the assessment and implementation processes.

The interviews identified several interrelated issues that constrained the implementation process: the potential for SMI eligibility not to be identified at first claim stage; poor and incomplete information from borrowers; and poor communications. The interviews indicated that lenders, Jobcentre Plus staff, Department for Work and Pensions (DWP) and borrowers could all contribute to making the administrative process difficult, cumbersome and delayed. These constraints did not necessarily result from the 2009 changes, but were nevertheless important in understanding the implementation of the 2009 (and 2010) changes.

3.2.1 Identification of claims

The administrative systems that support the delivery of SMI have been subject to some change recently. First there have been some changes to the handling of enquiries and new claims across Jobcentre Plus business as a whole. Second, and specifically in relation to SMI, to ensure that as many awards as possible are made on time at the end of the qualifying period, the SMI administrative system was subject to some changes during 2010.

At the point of a first claim (for Jobseeker's Allowance (JSA), etc.) claimants provide information about their housing costs which enables Jobcentre Plus to identify their potential eligibility for SMI. Claimants with mortgages are provided with a leaflet (IS8) that provides information in relation to SMI. Around six weeks into the claim, the processing team make contact with claimants by phone and discuss the potential claim. They then issue an enquiry form (MI12), together with any necessary requests for supplementary information. The form is completed in two parts, by the claimant and the lender. When it is returned, and all necessary information has been gathered, the processing team assess the case and where appropriate progress SMI through to payment.

While the overall administrative structure and principles are clear, the interviews showed some variation in practice as processing teams sought to provide the best service particularly in the

context of rapidly rising demand (both new claims and SMI applications). There were also limited instances where the administrative changes were not yet fully implemented.

The effectiveness of SMI is fundamentally influenced by the correct identification of mortgagors at the new claims point and Jobcentre Plus staff recognised that, on occasion, claims did get missed.

'The whole scheme is like a pack of cards. You pull the bottom card out and it all collapses. It relies on us being notified by new claims of an [SMI] claim. If they don't notify us at the new claims stage then we will never know.'

(Jobcentre Plus)

A similar point was made by a number of advisers who indicated that SMI cases were missed 'because of the silo mentality in Jobcentre Plus' whereby the focus in new claims teams was on assessing normal benefit eligibility, sometimes to the detriment of an identification and consideration of housing costs.

'...certainly initially we were finding clients who were coming through who were eligible, who'd been to the Job Centre maybe when they signed on initially but they knew nothing about the scheme. More recently though it is a lot better.'

(Adviser)

Advisers indicated that they routinely had to send clients back to Jobcentre Plus to inquire about SMI eligibility, but also recognised that where people lose their jobs their first thought is how to cover basic household income and so SMI is not to the fore in a claimant's first contact with Jobcentre Plus. SMI recipients interviewed in the Phase 1 study also made the point that they lacked familiarity with the benefits system and with SMI in particular. In a number of cases, their eligibility for SMI had not been identified on first contact with Jobcentre Plus and/or they had received incorrect advice. Similarly, while Jobcentre Plus staff have a duty to consider all working-age benefits (including the SMI component), they see relatively few customers with a potential eligibility for SMI. Advisers and Jobcentre Plus staff also indicated that linked (repeat) claims and changes from one benefit to another were points at which an SMI claim or re-instatement of a claim could be missed, despite the fact that the transfer should be undertaken seamlessly by Jobcentre Plus.

'Rapid re-claims are done as a change of circumstance (not undertaken by new claims)... they [the appropriate section] are not always thinking in terms of referrals for mortgages. The instruction is to re-instate the claim but to take off housing/mortgage costs. The claimant will think the mortgage payment will re-instate automatically and contact [us] after a couple of months when this hasn't happened.'

(Jobcentre Plus)

'If someone is on Employment and Support Allowance (ESA) and this is reassessed saying the claimant is capable of work, the ESA stops. SMI then stops as well. It can take a while until re-instated, perhaps on appeal of the decision. But this does not always trigger the re-instatement and clients aren't always aware of this.'

(Adviser)

The Phase 1 report noted that borrowers were often unfamiliar with the benefits system and sometimes failed to realise soon enough that they were eligible to make a claim (Munro *et al.*, p.16). Advisers interviewed in Phase 2 indicated that borrowers often lacked any information about SMI in particular, and reported that this continued to be the case after January 2009. The Department for Communities and Local Government did, however, increase their dissemination activities and

they provide many links to information on SMI primarily from their mortgage pages, including a calculator. The output from the calculator, however, identifies how much JSA a claimant might receive and how much would cover 'housing costs', rather than more directly identifying the support as SMI to assist home owners. Borrowers unfamiliar with the benefits system might need the information to be more explicit.

In time, missed cases were frequently picked up by lenders, in discussion with borrowers about emerging arrears- 'SMI is part of our formulaic response to borrowers calling about arrears' – or by advisers if borrowers with debts sought advice from them. They were then directed back to Jobcentre Plus, but the consequence could be a delay in implementing SMI, and potentially additional financial costs to borrowers if arrears and costs accrued, and anxiety if lenders started possession action.

'It isn't just the accumulation of arrears but lenders make a charge £30-£40 a month just for being in arrears prior to an agreement being made. SMI [when paid] does not cover this. Also if lenders send a couple of letters out its £25 a letter.'

(Adviser)

3.2.2 Incomplete information

Borrowers are required to provide information on all their current loans to enable Jobcentre Plus to assess their claim. Their staff indicated that there were instances of borrowers returning incomplete information which led to a further round of requests. Advisers noted the amount of work this might entail. An MI12 form has to be completed for each loan or loans from a particular lender and there are a proportion of claimants that have multiple current loans from different lenders. Several lenders may have to be contacted. Both lenders and Jobcentre Plus staff noted that SMI claims were driven by compliance with a bureaucratic, paper process that had to deliver legislative requirements, rather than it being an advice and discretion-based approach, again a view that chimes with the responses from claimants interviewed in Phase 1 (Munro, *et al.*, p18). As a result, if borrowers submitted incomplete information they might have to go round the process a number of times. Borrowers could also lose forms, as could lenders. Two advisers noted that:

'We have numerous cases where forms get lost either as they go to the lender or from the lender back to Jobcentre Plus.'

'...insufficient information supplied by the clients and forms going backwards and forwards to the lender.'

One further adviser noted that:

'and it's not uncommon in this period for a mortgage lender to start possession action and so the client incurs more legal costs, etc..'

SMI covers the interest on the portion of a mortgage loan that relates to housing provision or to specific home improvements or parts of improvements⁸. Borrowers, therefore, have to indicate that a loan fulfils these criteria. This is usually straightforward for housing costs but not necessarily with respect to home improvements. As a result it is possible that the amount of SMI payable will

⁷ Where an error or delay occurs, Jobcentre Plus can make provision via special payments to cover costs that fall to a customer as a result of the delay or error.

⁸ For example, interest on a loan to install central heating is not allowable, but the interest on a loan to replace a boiler is allowable. Expenditure for improvements such as worktops for preparing and cooking food is allowable while cupboards for food storage are not.

be less than it could be because borrowers cannot provide any or adequate documentation. It is not possible to put any scale on this 'shortfall', but advisers noted that it did occur. In some cases these loans were long standing and the need to retain receipts had (not unsurprisingly) not been recognised.

'I've had a few cases where there are secured loans and clients can't remember what the loan was for, often home improvements and debt consolidation are jumbled up together and so helping people back track to identify how loans were spent...DWP have then to decide what they think will be eligible.'

(Adviser)

'Some people are coming forward with several secured loans. Can be very much in the lenders' hands regarding what loans were actually made for and this can be quite a challenge to untangle. People rarely have their own documentary evidence of what the money was spent on.'

(Adviser)

'Often a big delay with second mortgage issues and loans for home improvement. The requirement for proof of what it was for often causes a delay and delays the whole claim rather than just the bit that was [a loan] for the kitchen.'

(Adviser)

The interviews suggest that there was some variation in the importance of this information and in the way eligible amounts were assessed, (despite a presumption within Jobcentre Plus that the decision will be made on the evidence available and the balance of probability). In one Jobcentre Plus office a respondent noted that:

'There is little discretion [within the SMI assessment process] except on the issue of what can be taken as evidence and these have to be referred to more senior officers.'

'[Unusually] These officers come from appeals teams and are very strict interpreters of the rules and decisions can be harsh. [It] would be better to go on the balance of probability. For example some loans go back so long there are no papers available' and adding 'The whole purpose of the scheme is to prevent losing a roof over their heads. To get someone evicted for the sole reason they can't provide a document from ten years ago seems very harsh.'

Another respondent, however, noted that they did not ask for individual receipts but based their judgements on questions about whether the claimant had ever borrowed more money and what they had spent it on, checking against the final statement of the original loan for house purchase.

3.2.3 Poor and limited communication

All parties made mention of poor communication, and in particular both lenders and Jobcentre Plus staff could portray the other as unhelpful. Each party often had wishes or expectations of the other that were not accommodated, sometimes because it was not the current practice, but sometimes because of wider structural constraints such as data protection. One Jobcentre Plus interviewee gave the following illustration whereby:

'Some [lenders] complete the form by hand and sometimes it is not possible to read the numbers – whether it's a one or a seven for example. When staff then make contact by phone they find the lender won't clarify on the phone and so the form has to be re-sent which causes a delay. Other lenders attach a print-out that contains the basic information but not always in

the form required by Jobcentre Plus. [A specific example given was where the MI12 requires total outstanding balance minus total arrears but the lender's print-out often includes arrears in the balance].'

This particular office had formed a judgement about how to respond to and use such information in that they made their own assessment of how much the total balance outstanding related to arrears but they saw having to do this as something that was 'awkward'.

Jobcentre Plus also decline to discuss/disclose individual cases with lenders, reflecting data protection requirements. One lender said:

'DWP never talk to us. DWP goes through the customers who are not financially literate and are under stress...It should be perfectly possible to seek the customer's authority to talk to us.'

There would be mutual benefits from closer liaison between lenders and Jobcentre Plus staff, as lenders noted they would be able to check what period payments represent and why claims stop, for example, and Jobcentre Plus staff could clarify lender responses to the MI12 form. Jobcentre Plus are now introducing an addition to the MI12 form which seeks the customer's authority for them to talk directly to lenders.

Recent changes in the handling of enquiries as noted above have also had an impact on communications between Jobcentre Plus staff, borrowers and money advisers about SMI. Prior to 2009, advisers noted that if they had a query from a client about SMI it was straightforward to call the person or team with SMI responsibility and sort out the query. Following the re-organisation of enquiry handling, queries now have to be addressed to the contact centres where the only information available to staff about SMI is an identifier on those cases considered likely to be eligible for SMI (and which have been passed to a processing centre). Contact centre staff can explain processes and requirements using a checklist but cannot make decisions or answer more complex queries which have to be passed on to the processing centre. One adviser gave an example of where she had contacted Jobcentre Plus on behalf of a client where the person in the contact centre had a written script which she read out rather than being able to explain and answer questions.

Thus the administrative structure can, on occasions, cause delays and frustration and appear to be blocking rather than easing communications.

Some lenders argued that the outputs of the process could be made clearer. They indicated that they were not notified in advance of how much borrowers will receive and so it is more difficult to set up forbearance arrangements and advise borrowers. Others noted that they were not aware of which benefit their borrowers were receiving (in the context of the two-year rule that applied only to JSA claimants). Lenders appeared to have little appreciation that information of this kind, along with that of a claimant's borrowing profile is, because of data protection, not information that Jobcentre Plus staff are free to forward. Assessment of eligible costs may also be close to the point of payment, such that prior notification is difficult. One lender noted that it would be useful to have a discussion with Jobcentre Plus about the whole process and decision making so that they could understand the process and constraints more satisfactorily⁹.

More generally, lenders, advisers and Jobcentre Plus staff were unanimous in their view that the system produced letters of notification from Jobcentre Plus and the Pensions, Disability and Carers Service to claimants in respect of the 2009 changes were poor, and with respect to the 2010 changes very poor indeed (see Chapter 4). The 2010 letters were reported as being complex, difficult for some borrowers to understand, inaccurate, in respect of the reason for the (Standard Interest Rate) SIR change, and late.

⁹ Jobcentre Plus has been working with the Council of Mortgage Lenders to take this issue forward.

3.3 Implementing the SMI change: contextual constraints

3.3.1 Interest-only mortgages

SMI is most effective when an interest-only mortgage is in place. Assuming all the interest meets the eligibility criteria, there is no need for a forbearance arrangement with respect to capital payments and so no risk that arrears will accrue.

‘SMI is most effective in interest-only mortgages.’

(Adviser)

Interviews with advisers and some policy stakeholders suggest that the willingness of lenders to convert capital and payment mortgages to interest-only mortgages (and so maximise the impact of SMI) was quite widespread initially. It was also noted in Chapter 2 that this change sometimes had to be negotiated. Where lenders were not prepared to make this change, advisers reported that they offered a range of reasons why this might not be possible or a good idea.

‘Some lenders, in some cases, have been reluctant to put people on to interest only, and then negotiations can delay things...Sometimes they claim not to offer interest only to people in arrears “not part of their business to make this an option”.’

(Adviser)

‘One complication is the extent to which lenders are willing or can (in commercial terms) change loans to interest only. The reluctance may arise from lenders having to cover their own borrowing costs, or they may require capital payments to be in place in order to contribute to capital adequacy requirements.’

(Adviser)

During 2010, advisers noted that they began to see lenders become more cautious over conversions to interest-only mortgages, and as noted in Chapter 4, this has gathered momentum since October 2010.

The consequences of conversion to interest only in the short run removes the need for the borrower to make capital payments and has increased the likelihood that SMI will support the avoidance or limitation of arrears. Where a lender has not agreed to interest only, the impact of SMI is more limited. The longer term consequences of interest-only mortgages may be more debatable, but outside the scope of this research.

3.3.2 SMI in the context of non-qualifying loans

The historical close fit between SMI provision and actual mortgage interest owed began to be challenged in the late 1980s and early 1990s as a result of a more competitive lending market and house price inflation. In general, over this period, borrowers had rising equity and the opportunity to withdraw some equity, sometimes for home improvements but also for non-housing purposes such as holidays or school fees. The boom in mortgage lending facilitated this process which occurred through serial re-mortgaging, second charge lending, and/or via secured consolidation loans sold to manage debt. In recessionary periods remortgaging to consolidate debts is more prominent but in the 2008 recession it virtually ceased as a result of the shortage of credit.

As noted earlier, SMI is a provision for interest in relation to loans for basic housing and specified home improvements, for borrowers with entitlement to certain qualifying benefits. The changes

in the use of mortgages noted above result in an increasing number of cases where there is a gap between the interest related to loans that meet basic housing and home improvement costs and the mortgage costs due to lenders. In this context, even where SMI covers interest on all eligible costs, and thereby limits arrears on these qualifying loans, depending on the borrowers' borrowing profile, its impact may not be large enough to prevent significant arrears on the mortgage as a whole or to prevent lenders starting possession proceedings.

A number of respondents also noted the exclusion of particular groups from receipt of SMI, because despite a lack of, or very little, income they were not eligible for a qualifying benefit. The self-employed and dual earner low income households were most frequently cited. Again this is an issue of the design of SMI and the extent to which it has to keep pace with the changing pattern of labour market activity. Some respondents noted that this recession is characterised by short-time working to a greater extent than previously and also by repeat temporary working, which, depending on the exact hours of work, may exclude a claim for SMI. These comments from respondents raise the much broader question of what a comprehensive safety-net for mortgagors should cover in contemporary circumstances, although consideration of this broader issue was beyond the remit of the project.

3.4 Summary and conclusions

There are two main constraints on the effectiveness of SMI. The first results from shortcomings in the assessment and administrative processes associated with SMI. Lenders, borrowers and Jobcentre Plus all contribute to these shortcomings. They principally relate to the non-identification of likely SMI cases at the first claims stage or on transfer of benefit, to incomplete information and to poor communications between all parties. The complexity of the benefit rules and of borrowers' borrowing profiles makes such constraints likely, but there are also issues of data protection. The increase in the SMI work load within Jobcentre Plus associated with the shortened waiting period initially limited the effectiveness of the implementation process. All these factors act to delay claims, but a failure to document the purpose of a loan can make the decision-making process more difficult and may result in the customer not getting the correct award of SMI in relation to potentially eligible interest. Delayed claims may also result in further financial costs to borrowers and potentially can increase arrears.

The second set of constraints on the effectiveness of SMI is a result of factors external to SMI. The effectiveness of SMI may be less where lenders are unwilling or unable to convert a borrower's mortgage to interest-only as the borrower still has to meet capital payments to preclude arrears. Further, while SMI may be effective on its own terms, if a borrower has significant non-qualifying loans on which arrears mount the receipt of SMI will not preclude arrears on the mortgage(s) as a whole which may lead to possession.¹⁰

It is important however, to consider Chapters 2 and 3 together in order to have a full account of the responses to the SMI changes and the impact of these responses on its effectiveness. Here the balance is clear. Despite some delays, poor communications and some cases where the context limits the overall effectiveness of SMI, the changes have resulted in more people being assisted, more fully and sooner. Borrowers have accrued lower levels of arrears or none at all and in the context of earlier payment and the SIR lenders have been more willing to forbear.

¹⁰ Where the loans secured on property are for purchases such as cars, borrowers may try to sell them but their value has often reduced. Secured loans for ineligible home improvements cannot be 'redeemed' in this way and may contribute to arrears.

4 The responses to and impact of the reduction of the SMI SIR in October 2010 and preliminary evidence of the impact of the two year limit on SMI for some claimants

4.1 Introduction

The June 2010 Budget announced some further changes to the package of measures put in place in January 2009 to prevent mortgage possessions. From October 2010, the Standard Interest Rate (SIR) payable on Support for Mortgage Interest (SMI) was reduced to 3.63 per cent, the funding for the Mortgage Rescue Scheme (MRS) was extended for a further two years although it was curtailed. Funding for advice provision via the Financial Inclusion Fund was to be ended (but was subsequently re-instated for a period from a different source). The new SIR is based on the published average mortgage rate on 31 August 2010 which is 3.63 per cent. This rate is based on information from around 25 banks and building societies, covers over 75 per cent of all banks and building societies' mortgage business and is a weighted average of all existing loans to households secured on dwellings in the sample. Any subsequent changes to the SIR will only occur when the Bank of England average mortgage rate differs by 0.5 per cent or more from the SIR in payment.

Assessing the impact of the proposed reduction in the SIR, the Department for Work and Pensions (DWP) indicated that 'around 50 per cent of SMI customers would continue to have eligible costs paid in full (115,000 mortgagors). Fifty-two per cent of SMI customers would have at least 90 per cent of their eligible interest outgoings covered by the benefit award' (DWP, 2010).

The assessment concluded that:

'Paying SMI based on the Bank of England published average mortgage rate of 3.63 per cent will lead to fewer customers being fully covered in terms of their eligible mortgage interest outgoings and a faster build up of arrears for those in the shortfall position compared to the current, frozen rate of 6.08 per cent.'

In respect of the critical issue of how lenders would then respond to growing shortfalls the assessment notes that:

'Based on conversations with the CML we would expect lenders to demonstrate forbearance in the vast majority of these cases.'

The interviews with lenders and advisers provide a first look at the response to the lowered interest rate, and provide a preliminary indication of whether the above expectation is likely to be realised.

A second issue considered in this Chapter is the response to the position of the first Jobseeker's Allowance (JSA) claimants to reach the end of their two-year payment period.

4.2 The response to the reduction in the standard interest rate

Lenders, advisers and stakeholders recognised that the package of measures would not continue, in part because all government departments were seeing budget cuts, and in part because the context had changed and in particular falling interest rates resulted in an increasing proportion of borrowers in receipt of SMI benefitting from over-payments. Equally, however, they highlighted that economic circumstances were still difficult, that unemployment was rising, at best house prices have been static for several months and there was widespread recognition that borrowers and the housing market still needed support.

Lenders and two of the three stakeholders reported that the changes were announced (in June 2010 as part of the Budget) with little, if any, prior consultation or notification to stakeholders or lenders, although key stakeholders had continued their lobbying as the Comprehensive Spending Review was underway. Once the changes were announced, there was liaison between DWP and the Council of Mortgage Lenders (CML) with information cascaded from CML to their members. DWP wrote to their stakeholders after the budget announcement, but before the change was implemented, to confirm the change and the new SIR.

One stakeholder noted that they were 'surprised' by the retention of money for MRS and that most of the temporary SMI measures had survived. A lender commented that:

'It was common sense that the SIR was a likely candidate for change given that base rate was now so low.'

However, a number of respondents had argued that too great a reduction in the SIR too quickly would be damaging and they had lobbied for support nearer to 4.5-5 per cent.

'The change that was implemented – a reduction in the SIR – was the worst change possible because it fuelled arrears. A reduction in the capital limit or some increase in the waiting period (but well short of 39 weeks) would have been better options. Lenders were disappointed.'

(Stakeholder)

'A giant step with no warning was extremely cruel to extremely vulnerable borrowers.'

(Sub prime lender)

All lenders expressed concerns about the changes to the SIR. However, their differing profiles meant that lenders with a cautious approach to lending and a mature mortgage book had fewer concerns than lenders weighted towards more recent loans (where interest makes up a greater proportion of contractual payments), or a significant profile of higher rate loans. Given this range, nevertheless, lenders consistently reported that they would have preferred SMI to reflect actual interest rates, although they also acknowledged the administrative burden associated with such an approach.

'I understand the point of moving to an industry average but as a lender with higher risk borrowers, they are the people most affected, the most at risk anyway. If it could have been banded or paid at the account rate...the simplicity for the Government has created complexity for the lenders.'

(Specialist lender)

All participants appreciated that paying the SIR at a higher rate could be considered to be poor value for money as many mortgage accounts were being overpaid with public funds. However, one informant noted it would have been appropriate to retain the higher rate in view of worsening arrears and possessions. Particularly so in the context of a mortgage market with widely disparate loan rates, where any amendments to the SMI administration to reflect actual interest rates was too onerous and where there remains a significant minority of borrowers paying very high fixed and/or subprime interest rates. Two of the key players suggested that the welfare reforms and Universal Credit might provide an opportunity to make this change.

4.2.1 Overpayments and shortfalls

As noted in Chapter 2, a large proportion of borrowers in receipt of SMI received 'excess payments' prior to October 2010 and had either avoided arrears and/or accrued significant 'credits' on their accounts, the size of which is dependent on how long their SMI has been in payment. In some cases SMI had been covering capital shortfalls and interest on non-eligible loans held by the same lender as the eligible loans.

Post October 2010, all claimants were receiving less and lenders pointed to a range of outcomes:

- Borrowers whose SMI still exceeded their mortgage interest rate and who could continue to cover all of any other interest costs and capital costs.
- Borrowers whose SMI still exceeded their mortgage interest rate and who could continue to cover some of any other interest costs and capital costs but at a lower level.
- Borrowers where SMI matched all eligible mortgage interest but where they could no longer contribute to other loans or shortfalls either as much as before or not at all and where arrears would emerge.
- Borrowers whose SMI was below their current mortgage interest rate and where the gap was likely to lead to the emergence of or an increase in arrears.

Many lenders still had a proportion of borrowers in the first two categories above, but this pool was smaller than before, and the reducing overpayments were making a smaller contribution to capital payments or interest on non-eligible loans.

One of the impacts of the SIR having been at 6.08 per cent was to delay recognition of the full impact of the new 3.63 per cent rate, both for existing borrowers and lenders. As a result, three months into the new SIR regime, lenders reported that they were only just beginning to be able to estimate the likely impact of the cut.

'Too early to say what the impact has been as some people had built up a buffer when the rate was higher. We've only had three months of the new rate in our stats. We may not see the full impact in a quarter or even in six months...It depends when people came into the scheme and how much buffer they built up. Although some will now have shortfalls it will take some time for accounts to fall into arrears. Also new claimants won't miss what they never had.'

(Prime lender)

Some lenders were, however, able to provide an early indication of the ongoing build up of short fall payments and so arrears.

'Shortfalls have increased [on average] from around a £100 a month to £200 and people are beginning to struggle to pay that.'

(Prime lender)

28 The responses to and impact of the reduction of the SMI SIR in October 2010 and preliminary evidence of the impact of the two year limit on SMI for some claimants

Another lender noted that in July 2010 their average SMI was £424 with most borrowers receiving between £330 and £550. In November 2010, the range was £218 -£252 and they estimated that between 20 and 30 per cent of borrowers whose accounts had previously been stable or ‘curing’ would now ‘start to roll’ into arrears. Another building society said that prior to the rate reduction 25 per cent of borrowers in receipt of SMI were in arrears, but that figure had now increased to 46 per cent, although across their mortgage book however, only one per cent of borrowers were in receipt of SMI. It is, therefore, clear that the proportion of borrowers receiving full eligible costs, meeting shortfalls, or developing arrears has shifted unfavourably.

In general, however, lenders cannot estimate shortfall payments for borrowers ahead of DWP notification as they are not aware of their borrowing history.

Advisers reported that they were already dealing with the impact of the SIR reduction, (perhaps not surprisingly as they have most exposure to borrowers with the most difficult financial circumstances). A key issue is the lack of knowledge among clients about the reduction in their SMI payments (advisers noted that some had found the letters from Jobcentre Plus difficult to understand and some did not think they had received a letter; in some cases borrowers’ grasp of their financial circumstances, which were often complicated, was limited) and then there are the financial implications of how they can manage emerging arrears.

‘They don’t know about it to be honest. We’re getting a lot of people coming in who say they weren’t aware that this has changed and the first time they become aware of it is when they get a letter from the lender saying you’re in arrears because your payments are not being covered. Because other income [JSA/IS/PC/ESA] stays the same people assume all the payments are the same. Despite a letter going out from DWP the clients are at a point where they don’t read letters or they have a disability and don’t assimilate the information.’

(Adviser)

‘Lots don’t know there has been a change...As a result [Citizens Advice Bureaux] CAB are seeing more cases where this is a problem.’

(Adviser)

‘A lot of people don’t know they are now getting into arrears.’

(Adviser)

‘There is a lot of evidence [from our offices] that people are coming in and saying their shortfall has gone through the roof. This will fall primarily on vulnerable people or those with sub-prime mortgages. Lower incomes paying higher rates and can’t get off them. People who were just managing a shortfall can’t manage any more.’

(Key player)

Much less frequently advisers noted that they, or their court desk colleagues, were also seeing a small number of cases where borrowers were being brought forward for possession as a result of SMI shortfalls. Thus, the issue of lenders’ forbearance stance in the face of falling payments is critical.

4.2.2 Lender forbearance

Many of the lenders interviewed undertook their own notification exercise with their claimant borrowers.

'We rang every single customer in receipt of SMI to clarify the new situation and built a shortfall calculator for each adviser to work out what the shortfall was likely to be.'

(Specialist lender)

Most lenders did not build shortfall calculators and could, therefore, only send a generic letter to borrowers about the incoming change as there is no advance notification from Jobcentre Plus to lenders of new payment levels due to data protection requirements. Some reported that the response to their letter was mixed with some borrowers not having heard of the change.

The nature of lender forbearance has been a critical contributor to the containment of arrears and possessions during this downturn. Gradually from early 2009 more lenders moved towards a 'managed forbearance' approach and made extensive use of a range of tools to support borrowers, albeit that forbearance was inconsistently applied across the market. Chapter 2 noted the extent to which, following the January 2009 initiatives, lenders had their forbearance options underpinned by SMI and were more willing and able to offer concessionary payments, loan modifications and to tolerate shortfalls.

The evidence from interviews with lenders, key stakeholders and advisers indicate that options for, and attitudes towards, forbearance have been challenged by continuing economic conditions, but centrally by the reduction in the SIR introduced in October 2010. The interviews revealed a growing questioning of the desirability and feasibility of continuing to extend forbearance to some borrowers. Providing further forbearance in some situations may not be in the borrowers' interests in the context of a falling housing market, increasing debts and rising unemployment. Lenders noted that the downturn has lasted longer than originally anticipated and the policy context for lenders has changed since they adopted these forbearance approaches at the beginning of the recession. Furthermore, one lender noted that strategically, there are regulatory pressures on lenders from the European Union and the Financial Services Authority regarding the amount of capital that should be set aside for mortgage accounts in arrears that mean an important element of the costs of forbearance have increased.

'Clients are looking at forbearance policies but acting piecemeal, tinkering round the edge. They have to consider when is it appropriate? For how long is it appropriate? Are the policies adopted a couple of years ago still appropriate?'

(Lender Servicer)

While it was not apparent from the interviews that lenders' appetite for forbearance on new cases had diminished, it was clear that there was a growing sense that lenders could no longer sustain forbearance on cases where forbearance had been a feature for some time and where cases were likely to deteriorate as a result of reduced payments from SMI. Lenders, key players and advisers all indicated that sentiment was changing as to how realistic it was to continue recent patterns of forbearance, even though for the moment all the lenders interviewed continued to forbear.

'There has been no formal shift in our behaviour or treatment towards SMI, if it starts to roll, we'll go through the due processes.'

(Specialist lender)

A minority of lenders (with both prime and sub-prime loans) considered a partial payment of SMI was better than no payments at all, as at least the account was being serviced. One building society suggested that their approach to SMI shortfalls was that they would request that borrowers made up the difference, but if the borrower was unable to do this then no further action would be taken if SMI was still in payment.

30 The responses to and impact of the reduction of the SMI SIR in October 2010 and preliminary evidence of the impact of the two year limit on SMI for some claimants

Nevertheless, a number indicated that they had the right to re-appraise their approach, which might have come to its limits.

'We're doing a lot of forbearance and a lot of adjustments, but legally we have the right to repossess and haven't done.'

(Specialist lender)

'[Ending forbearance in some circumstances] is only fair to borrowers and it isn't in the spirit of Treating Customers Fairly if we go on and on.'

(Building Society)

'There is a limit to how much we can forbear, there's not much left in forbearance...the customer will either be able to make up the shortfall or they will face possession in the future.'

(High street lender)

Another lender perceived that the pressure on lenders to forbear had changed somewhat, and that the messages were slightly different, signaled by the future ending of the Homeowner Mortgage Support scheme and limited further year of funding for the MRS.

'...in the pipe line there are difficulties with extended forbearance [and] it's only a matter of time before we see them filter through to possessions unfortunately.'

This lender thought that the tone of CML comment and discussions now implied that 'enough is enough' and, in addition, believed that DCLG now had more sympathy with the lenders' position than had previously been the case.

Key players also recognised the emerging tensions around forbearance.

'Starting to see households facing a shortfall...Unsure how lenders will handle these cases. Lenders will assess the likelihood that they will get back to work, their levels of equity but it will be harder. We'll start to see households with unsustainable shortfalls, start to face repossessions as a result. We'll continue to meet lenders and encourage them to pursue forbearance options.'

(Key player)

Another key player noted that while lenders were still willing to forbear, there would be more 'difficult conversations' and more conversations about assisted exit. The outcomes of forbearance assessments will differ depending on the nature a lender's mortgage book as well as their assessment of the borrowers' circumstances, the availability of equity etc.

A majority of interview participants considered that on balance the reduction in support from SMI would have a negative impact on lenders' assessments of accounts.

'If there are no growing debts on accounts then there is no financial reason to possess property. Where decisions get more difficult is that if not enough interest is being paid and the debt goes up and maybe equity is going down as house prices are falling. This may become an issue over SMI.'

(Prime lender)

'SMI is effective to support borrowers. The majority though have loans above 3.63 per cent and so it's harder for borrowers. The consequences are that more people are going into arrears and it is harder to get a solution to get rid of them [the arrears].'

(Building Society)

The tentative signs of a reappraisal of forbearance among some lenders in respect of some cases were supported by evidence from advisers and some key players. Advisers reported that there were cases where lenders had:

'...more reluctance about interest only and that's probably a first step to seeking possession... Some cases where interest only arrangement is negotiated on a month by month basis.'

(Adviser)

A key player noted that:

'...a couple of cases have already been passed to possession proceedings [where the lender had ended the agreement for interest only payments] so the changes are starting to push possession as well as arrears.'

(Key player)

Overall, the interviews indicate that the impact on lenders of the SIR change and a greater pool of borrowers with potential if not already growing arrears has been to push them towards a 'tipping point' at which they have either begun or are likely to reconsider their attitudes to forbearance and the role it is playing. Lenders are different distances from the tipping point, depending on their mortgage book etc. and for many it is too early for any full assessment of the likely outcomes. While some lenders have made little if any change to their forbearance to date, others have started a process of reappraisal. There is a sense of a stronger recognition that for some borrowers, lenders are running out of options and lenders and some key players are more willing to see a reappraisal of forbearance and possessions as a legitimate position.

4.2.3 Two-year time limit

There has been no information from DWP of the numbers likely to be coming to the end of the two-year limit to SMI as from January 2011. There are currently approximately 34,000 JSA SMI claimants, but no analysis available of how long they have been making a claim. The Impact Assessment that accompanied the 2009 changes could only note that at that time three per cent of JSA claimants had claims in excess of 104 months (two years). Lenders and key players interviewed noted that while claims of this length might be rare, the economy had worsened since then. More people than initially presumed might be affected over the coming months. (The proportion of the SMI case load that is JSA claimants rose from four per cent in January 2009 to 14 per cent in August 2010 (DWP, 2010)).

Lenders indicated that they have no sense of whether any of their borrowers have or are about to lose SMI because they have reached the end of a two-year claim. Nor can they identify which benefit an SMI recipient is receiving (see Chapter 3). They simply see a lack of payment and then have to pursue the reason for this with the borrower. Few cases had yet been identified by interviewees, either lenders or advisers, although some lenders were beginning to analyse their management information to try establish the likely impact.

Only one lender had a concrete example of a borrower whose SMI had been withdrawn after two years and had referred them back to Jobcentre Plus. The others speculated about what their attitude would be, but there was a consensus that the likely outcome would be possession or another exit from homeownership.

'We will know end of January but what do we do next? Not going to get a lot of lenders increasing forbearance. It feels like this year or next...lenders have been forbearing but putting off the inevitable. With the two year time limit, if people have not got other income, how long is temporary? We'd probably move on to the next steps, assisted voluntary sales or identify eligibility for MRS or even repossession.'

(Building Society with mixed mortgage book)

32 The responses to and impact of the reduction of the SMI SIR in October 2010 and preliminary evidence of the impact of the two year limit on SMI for some claimants

Another lender indicated that the time limit on JSA claimants affected what forbearance they could now offer. They were no longer willing to offer loan modifications for any claimant on JSA as JSA/SMI is an unsustainable source of income. Further:

'If someone has been on JSA-based SMI for two years it's unlikely they are going to get a new job and we would have a final re-examination of what exits might be available.'

Advisers believed that very few borrowers were either aware of the two-year rule in principle, or that it was now ending for some.

'We would expect a flood of people over the next few months.'

Advisers also perceived that lenders would not be able to continue to forbear when no SMI was in place. In some cases advisers also believed that the reassessment of the two-year limit cases would have implications for lenders' willingness to forbear on cases earlier in their SMI claim.

'...lenders are beginning to consider a shift in their responses. They can no longer sit back and tolerate shortfalls particularly where SMI will disappear after two years and the problem grow.'

(Adviser)

'Lenders aren't coming forward with options on these (SMI withdrawal) cases...won't negotiate with advice agency or the borrower. Even where the courts are sympathetic lenders are pressing for possession and 28 day orders are being given.'

(Adviser)

One key player commented:

'Surely it will be difficult for a lender to still forbear when there is no evidence of a recovery. I can't see that there is an awful lot that can be done. MRS would be an option for some but they've probably been through all the forbearance and experienced an interest rate cut and have arrears. There will not be a huge amount an adviser can do to get them out of that.'

As with the SIR reduction, the spectre of the first exits from a time limited SMI appears to be encouraging a move towards the tipping point identified earlier, although not at a uniform speed. The continuing sluggish economic conditions and the likely further impact of public sector cuts on unemployment all provide a context within which it is difficult to see how many borrowers with substantial shortfalls can recover their position. Lenders and key players recognise this and are suggesting that these assessments contribute to the change in sentiment that is already impacting on forbearance and exits from home ownership.

A small number of respondents, (mainly advisers but some lenders) raised the broader issue of the relationship between the cost of SMI and the cost of Housing Benefit that would be paid if borrowers were repossessed and moved into social housing or the private rented sector. They made the suggestion that SMI was good value for the public purse, as well as precluding additional demand for social housing.

'He [The Minister for Communities and Local Government] won't save money as they'll arrive at the local authority in six months...and the costs will fall on the government and make it expensive and detrimental to families.'

(Lender)

4.3 Communication/implementation of changes

Almost without exception those interviewed were highly critical of the way the reduction in the SIR was communicated. Less attention was given to the notification of the ending of SMI after two years, but Jobcentre Plus respondents told us that initially claimants were to be notified eight weeks before their SMI ended, with the period now changed to 13 and eight weeks.

The communication problems related to the timing of the letters (which were sent in waves in September 2010), its poor drafting, the inaccuracies contained within it, and its lack of clarity about the changes. The fact that interviewees often recognised the constraints imposed by large IT systems and that Jobcentre Plus was under considerable pressure, were not strong enough reasons to overcome their concerns. A particular issue was the fact that a reduction in the SIR was presented to borrowers as a result of a change in their circumstances (against which they had the right to appeal) rather than a non-individually negotiable change in government policy.

'The policy announcement was well before October [it was in June] and people were saying that customers should get plenty of notice so [they] could adjust their spending. That didn't happen.'

(Key player)

'...letters are not fit for purpose. We have to give reasons for things, say what the consequences are but DWP [in fact the letters are issues by Jobcentre Plus] don't.'

(Lender)

'We're disappointed that they [Jobcentre Plus] communicated it so badly in autumn. It's the key safety-net and should be treated with considerable thought and [more] preparation than it was and communicated faster.'

(Lender)

'We have lodged a complaint with Jobcentre Plus regarding the wording of the letters because you...a client would not automatically know that they are going to be getting into arrears because there is a shortfall.'

(Adviser)

A Jobcentre Plus respondent commented more widely about the handling of the SIR change in October 2010.

'It was an automatic change that was made. The system was programmed to update the interest calculations over a weekend, but cases that had queries pending were not automatically done and had to be clerically changed when the query was solved. I have to say, in October we had a vast amount of enquiries [from borrowers] telling us they'd not got these notifications – and from lenders too. We checked and reported it up the line but the answer was that they had all gone out.'

(Jobcentre Plus)

'They've had a letter but they've not been able to understand it. I had a customer the other day asking for the letter to be sent out in plainer English.'

(Jobcentre Plus)

4.4 The effectiveness of SMI post October 2010

The SMI change introduced in October 2010 concerned only the SIR. With respect to the wait period, who was eligible and the eligible capital limit there was no change. Thus, help with eligible housing costs continues to be provided quickly and to reach the same pool of borrowers as before. Because the number of JSA claimants has risen over the period, more borrowers are being assisted through difficult labour market conditions than was the case in January 2009. There is a small (but unknown) number of borrowers now losing SMI completely.

However, with respect to the prevention or restriction of arrears and the prevention of possession, the evidence on the impact of the SIR change in October 2010, is that it has been detrimental and will become more so. All respondents noted that arrears and possessions were likely to increase. The ending of the two year period for the receipt of SMI for claimants who first claimed JSA in January 2009 is likely to be a further pressure to increase possessions even though the early impact of the change is to some extent masked temporarily by the benefits of the previous SIR. Nevertheless, shortfalls are mounting and the interviews show a change of sentiment among lenders and key players about the conditions under which forbearance can and should be continued, but to varying degrees. Many continue to forbear, but there is evidence that some lenders are less willing to do so in all cases and a small number are coming forward to the courts. Advisers report the consequences of this as they begin to see cases in the advice centres.

4.5 Summary and conclusion

Some scaling back in SMI provision was expected by lenders and advisers following the generous package of measures in 2009. The SIR reduction was implemented against the background of many borrowers having been enabled to meet their mortgage interest in full and often capital payments. Some had an absolute credit on their mortgage.

As a consequence, the severity of the cut for borrowers has taken some time to become obvious, but shortfalls are now accumulating, albeit there is variation by lender depending on the nature of their mortgage book. SMI is less effective than it was between January 2009 and September 2010 in terms of preventing arrears and possessions.

Lenders are increasingly prepared to re-consider their forbearance approach as arrears look likely to mount. Again there is a range of responses, but the growing shortfalls and the continuing recessionary conditions have created an environment that facilitates a change in sentiment and moving lenders towards a tipping point where a change in practice is likely. There are early cases coming through to the courts for possession. The interviews raise some doubt about the robustness of the CML's claim that lenders will continue to forbear despite rising arrears due to the reduced level of SMI. Difficult economic conditions and tighter regulatory requirements add to the pressure for some re-evaluation.

The letter to those in receipt of SMI about the 2010 SIR change was judged by lenders, advisers and key players to be very poor and counterproductive. Borrowers had little time to plan for the financial adjustment as well as it being reported that they had difficulty in understanding the content. Lenders and some stakeholders were also disappointed by the lack of consultation with them on the changes.

5 Conclusions

The research reported here was commissioned as the second phase of a project evaluating the success of temporary arrangements for the Support for Mortgage Interest (SMI). The specific purpose of Phase 2 was to provide an understanding of:

- the approaches and activities of lenders, advisers, Jobcentre Plus staff and key policy players in response to the SMI changes introduced in 2009 (and again in October 2010);
- the impact of these responses on the effectiveness of SMI.¹¹

This chapter summarises the main findings from the work in relation to these key questions and reflects on some emerging issues that the researchers believe may have implications for current and future policy towards sustainable home ownership. The research has considered changes that were introduced some two years ago and where the experience and responses of the various parties is now well embedded. The research also considered the October 2010 change in the Standard Interest Rate (SIR), and attitudes towards those borrowers who from January 2011 would reach the end of their SMI claim. Lenders' responses to these more recent events are still developing and the impact(s) are not fully clear. Nevertheless, the direction of change, and likely impact, if not its magnitude, is apparent.

5.1 Key findings

5.1.1 How lenders, advisers, key player and Jobcentre Plus approached and responded to the SMI changes

Lenders and advisers responded to the majority of the changes, the January 2009 changes to SMI, very positively. Only with respect to the two-year limit on claims by new JSA claimants was there a concern, although this was seen as materialising sometime in the future. The vast majority of interviewees concluded that the 2009 reduction to the waiting period, the SIR of 6.08 per cent and, to a lesser extent, the increased capital limit were the core components in the whole raft of interventions introduced by the Government to prevent possessions.

The reduced wait period and the SIR in excess of many borrowers' actual mortgage interest rate provided an added impetus to lenders to forbear, and advisers found that lenders were more willing to negotiate about converting mortgages to interest only arrangements and/or concessionary payments to address shortfalls. The 2009 SMI changes underpinned the forbearance environment, not least because interest on non-eligible loans and other shortfall payments were, in a proportion of cases, covered in part or whole by the higher SIR. The position of borrowers with interest rates above the SIR was difficult and disadvantageous but, in general, lenders continued to forbear.

The response of lenders and advisers to the October 2010 reduction in the SIR was one of disappointment, but a recognition that the previous generous arrangement could not continue as a good use of public funds. Many felt the reduction was too much too fast and would, in principle, have preferred to see SMI meet actual mortgage rates. The early indications from lenders concerning the implications of the cut on their behaviour suggest that SMI is now more likely to undermine the forbearance environment, and there is evidence that at least some lenders are

¹¹ Phase 1 considered the impact of the 2009 changes on borrowers against the policy objectives that the temporary changes to SMI would help more borrowers, provide help more quickly, assist people through difficult labour market conditions and limit arrears and possessions (Munro *et al.*, 2010).

changing their assessment of their ability and willingness to forbear, particularly for those borrowers with significant arrears and who have had forbearance arrangements for some time. For those lenders who have SMI borrowers still on high fixed rates that are now even further ahead of the SIR, this is a very significant pressure towards a reappraisal of forbearance. There is a question of whether and how lenders will approach new cases of default over the next few months. These borrowers will have little or no buffer and potentially greater shortfalls. Whether or not these newer cases will find themselves offered the same level of forbearance as longer standing cases have benefitted from, or whether lenders' response to them will be influenced by the changes in sentiment now emerging is a key issue. Key players also identified changing sentiment as an emerging issue.

A key part of advisers' work following both the 2009 and 2010 changes was providing clients with information about the changes and ensuring clients approached Jobcentre Plus if it looked as though their claim had been missed. Many borrowers lacked any information in their view. Post October 2010, their experience corroborates the evidence from lenders of an emerging forbearance environment that is less supportive of borrowers.

The 2009 changes to SMI were implemented in the context of Jobcentre Plus staff facing significantly greater workloads than previously. They recognised that the changes had been poorly communicated to recipients of SMI. In October 2010, Jobcentre Plus staff had to contend with the consequences of even poorer communications associated with the letters sent to claimants receiving SMI which were, in some aspects, inaccurate, difficult to understand and late. There was a degree of firefighting initially. The structure of SMI and its associated administrative system is in any case complex and the rapid changes exacerbated structural constraints. Over the period of the SMI changes, however, Jobcentre Plus have responded and have introduced a number of administrative changes designed to address delays, increase efficiency and provide better identification of potential SMI claimants, improving the service in some key ways.

Lenders' positive response to the 2009 changes was helped by the fiscal environment which delivered base interest rates at 0.5 per cent from March 2009 onwards, creating a downward pressure on tracker rate and standard variable mortgage rates. While unemployment was rising there were hopes that the recession would be relatively short lived, as would house price falls. By contrast, recent changes in the broad economic environment, such as rising unemployment, the prediction of rising interest rates etc. and little recovery in house prices reinforce the shift to some re-consideration of forbearance among lenders.

5.2 The impact on the effectiveness of SMI

Lenders' and advisers' responses to SMI had a positive effect on its policy intent between January 2009 and October 2010. Lenders reported that more borrowers were assisted to meet their payments and fewer borrowers developed arrears. Where they did have arrears, lenders more often than not tried to set up forbearance arrangements and did not routinely seek possession. Lenders were prepared to consider conversion to interest only mortgages thus ensuring the maximum impact of SMI.

Lenders' responses to the October 2010 changes, while still not fully formed, suggest that their impact will be detrimental in respect of arrears, forbearance and possessions. Three months after the lower SIR was introduced, many of the lenders interviewed reported that more of their borrowers had shortfall payments than previously and more borrowers were accumulating arrears. Advisers and key players provided corroborating evidence noting that they were already seeing cases where borrowers were unable to meet previously agreed or newly emerging shortfalls. Lenders were less willing to agree conversion to interest only mortgages and advisers were beginning to see

cases coming forward for possession. The impact of lenders' response to the two year SMI limit in cases of JSA was predicted to be a request for possession. One clear impact of the initial response of lenders to the two year limit (as noted earlier, a response that 'parked' the issue), has been a missed opportunity for an 'in principle' early consideration of the response to unrecoverable arrears. Specific cases were not identifiable until late in the two-year period but the DWP Impact Assessment made it clear that there would in all probability be some cases. This discussion is now emerging and is considered below.

The structure of SMI, and its administration, constrains the effectiveness of the delivery of SMI in a number of ways; claimants could be missed and payments delayed (but typically backdated) or borrowers receive less than the full eligible amount because of incomplete information. The bureaucratic, rule-based nature of the SMI administration provides little room for judgement and discretion that might benefit some claimants. Lenders argued that they would have benefitted from more complete and easier communication with Jobcentre Plus (but failed to recognise the limits of data protection requirements). These constraints exist irrespective of the specific details of SMI, but the speed of change in January 2009 and again in October 2010 exacerbated the communication problem.

SMI provides an uneven safety-net. It provides the best protection for recent, prime borrowers with straightforward borrowing for housing, particularly where they have, or are able to convert to, an interest only mortgage. The protection through SMI is systematically worse for borrowers who have higher interest rates, remortgages or debt consolidation loans, and capital and repayment mortgages. Many of the most vulnerable borrowers are in this category and their 'disadvantage' is exacerbated the higher their loan to value ratio.

5.3 Broader policy implications.

Many of the policy implications raised by the research on lenders', advisers', Jobcentre Plus staff and key players' responses to the SMI changes mirror the policy implications noted in Phase 1 based on borrowers' experiences. Phase 2 also raised some additional issues.

5.3.1 Better awareness of SMI

Advisers and lenders noted that SMI continues to be a poorly recognised and poorly understood benefit. This was also one of the findings from borrowers considered in Phase 1 of the research. Given its core role in the safety-net for homeowners this has to be addressed.

5.3.2 A more effective delivery process

Advisers and Jobcentre Plus staff were aware that claimants eligible for SMI were sometimes missed at the qualifying benefit stage, and where there was a change of qualifying benefit. The application process for SMI can require a great deal of claimants in terms of documentation and understanding of their borrowing history. Notwithstanding that the structure of SMI is complex by design and requires significant information, the process does not always deliver the benefit as effectively as it should and nor is it always as responsive to inquiries about cases as it should be.

5.3.3 The merits of standard rates against actual rates

Lenders and key players understood why SMI is paid at a standard rate, but many saw it as a distortion giving rise to both excess payments and underpayments in an unplanned manner. It is also inequitable as an SIR relates poorly to the range of mortgage products that are available and is more likely to disadvantage the most vulnerable homeowners, many of whom are concentrated

among the 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 distorted by an SIR.

However, this is not a straightforward issue. Pegging the SIR to actual rates could encourage lenders to increase mortgage rates. The wide range of mortgage products, the frequency with which new products are introduced and the rates on existing products changed, along with the frequency with which borrowers change from one product to another would make reflecting actual rates a very cumbersome process for lenders, borrowers and Jobcentre Plus, increasing the chance of error and delay. The logic of the current system, which uses an average rate (as described earlier) and adjusts periodically to given criteria, clearly has advantages but there are a set of issues around the best criteria to determine the average, and what should trigger a change to provide some forward certainty and to minimise the distortions associated with the current system and encourage a more even approach to forbearance across the sector. Discussions of a Universal Credit could be the opportunity to address this.

5.3.4 Maintaining SMI

The 2009 changes to SMI were 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. Overall it has provided considerable support to borrowers and the market. Cutting SMI provision is already proving problematic for some borrowers and any further curtailment of SMI is likely to escalate unsustainable home ownership.

5.3.5 Rethinking the two-year JSA/SMI limit

The expectation that most JSA claimants will find work within two years remains valid, but the growth of unemployment suggests that at least for the foreseeable future the proportion of JSA claimants unable to achieve this may increase. The timing of this benefit withdrawal looks unfortunate. If, following the cessation of SMI, possession is instituted or some other form of exit considered, the financial position of the claimant will deteriorate while these are put in place. Some consideration should be given to handling this 'gap', with one option being that SMI is allowed to run on while an exit is secured. More thought also needs to be given to the early identification of long-term JSA cases and the development of more imaginative approaches to their housing futures, particularly given the current depressed labour market. Without this there is a danger that the short-term benefits of significant support (and public money) will have been to little or no avail.

5.3.6 The relationship of SMI to contemporary mortgage and housing markets

The historical position was that SMI typically met all a borrower's mortgage interest, because all their mortgage borrowing was related to the provision of housing or eligible home improvements. This position 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, SMI may be effective in its own terms but in terms of the larger policy objective of preventing homelessness it is inefficient as a safety-net wherever a lack of documentation results in non-payment or where the other secured borrowing cannot be serviced such that arrears accumulate and possession results. There are some straightforward issues here of how well informed borrowers are about the scope of SMI and what they believe is covered that can be addressed by better information and its dissemination.

More fundamentally, there is a debate needed about what the appropriate scope of SMI should be given that all those with unserviced secure loans are at risk, whether the loan(s) was used for non-eligible housing expenditure, debt consolidation, welfare needs, school fees, or a holiday. On the one hand, there is the position that SMI should cover the interest on all secured loans with several different arguments marshaled in support; the overriding imperative of preventing homelessness; the precedent set by mortgage products that elide all forms of expenditure and savings, without penalty; the simplification of the system that would follow allowing speedier and more cost-effective delivery of SMI; the belief that most non-eligible secured lending is meeting welfare needs and not luxury expenditure. On the other hand, there is the position that SMI is a housing benefit and should be limited to housing expenditure (recognising that it may be desirable to widen the range of housing items deemed ‘eligible’). Supporting arguments would include less certainty about the proportion of additional secured borrowing that is replacement welfare, the problems of using public money to support the full range of secured expenditure, arguments about moral hazard and further borrowing etc. Given the limitations of the effectiveness of SMI in the wider context as demonstrated by the research, the need for this debate is clear, but fundamentally as part of the policy question about the redesign of the safety-net and how SMI should fit with other forms of safety-net (for example, private insurance or savings).

5.3.7 Pensioners in receipt of SMI

SMI is viewed as a short-term support to borrowers while they seek work or recover from ill health, and it acts in this way in many instances. The majority of SMI claimants however, are mortgagors in receipt of Pension Credit. Little is understood about this group; the length of time their mortgages have to run, the reasons for continuing mortgages etc. and whether SMI is in fact a long term benefit for them.

5.3.8 Delivering a soft exit from homeownership

The full impact of the rate reduction and the withdrawal of SMI for Jobseeker’s Allowance (JSA) claimants after two years may take some time to become apparent. However, all interview participants concurred that there will be an increase in the number of borrowers for whom homeownership is no longer sustainable. Lenders, advisers and key players noted the likely rise in possessions.

There have been good reasons to date why policy has been directed towards the prevention of possession, not least the objectives of limiting homelessness, giving borrowers the best chance of overcoming ‘temporary’ difficulties and so retaining an asset, and a recognition of the social, emotional and financial costs of possession. The only alternative to possession has been mortgage rescue which has been an attractive option, but eligibility is restricted to vulnerable households, and the price for MRS properties has been reduced recently. Its medium-term funding is uncertain.

Given the wish to avoid possession, a less attractive Mortgage Rescue Scheme (MRS), but more cases of entrenched arrears, there is a recognition by lenders, advisers and key players that the position of some borrowers is unsustainable. Among lenders there is a reconsideration of whether forbearance in such cases is delivering benefits to their borrowers as well as to themselves. This has resulted in a consideration of ‘softer’ exits from homeownership, including Voluntary Sales (VS) and Assisted Voluntary Sales (AVS)¹².

¹² VS refers to where a borrower facing possession is given a period of time in which to try and sell the property. AVS (or Supported Sale) is where a lender provides one or more of legal advice, help with legal costs, marketing assistance etc to borrowers to assist them in selling their home rather than going through the possession process.

Lenders have always agreed to cases of VS, and are now engaging with AVS. The private sale of a property avoids or reduces the associated costs of possession to the borrower and lender and usually results in a higher sale price. This may result in borrowers releasing equity to repay other debts; or reduce the size of the any shortfall debt due to the lender. Sales avoid the legal and property-related costs of possession such as clearing and securing property all of which are passed to borrowers.

Although individual lenders and key players are considering AVS, there is scope for bringing 'softer' exits up the policy agenda. Such a shift in emphasis will involve some cultural change; (including recognising that home ownership may have been expanded too far, and establishing a more collaborative lender/borrower engagement); some regulatory issues (for example that lenders continue to 'treat customers fairly' while assisting them to exit); as well as the development of new practices and should be considered as a socially responsible approach to unsustainable home ownership. Part of this policy consideration should be to ensure and enhance the extent of mortgage rescue.

The Phase 1 report suggested that an enhanced version of SMI might be 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) with SMI seen as an investment that would return funds to the public purse on the sale of the property. This option would need to be led by Government but would dovetail with the recognition of the costs of possession, the evidence from Phase 2 that lenders are likely to be reluctant to forbear indefinitely and the demands on social housing that homelessness creates. Compared to the costs of Housing Benefit it could be a cost effective housing option.

Appendix A

Research methodology

The research used a qualitative methodology.

24 in-depth qualitative interviews were undertaken with:

- Nine lenders including both prime and sub-prime lenders. The lenders included those with a branch network, those with a more centralised structure, and some who sold in part or entirely through intermediaries. An organisation who ‘processes’ arrears cases for a number of different lenders was also interviewed.
- Six advice workers in different agencies and different parts of the country.
- Jobcentre Plus staff with experience of identifying and processing SMI applications in six offices across five different geographical regions. In most offices one person was interviewed, but in two cases the interviews involved two members of staff.
- Three key stakeholders drawn from industry organisations, national advice services and central government.

Six interviews were conducted on a face-to-face basis and were recorded and then written up. The remaining interviews were undertaken by telephone. Extensive notes were taken and the interviews written up. The interviews were conducted in January and February 2011. A small number of the interviews involved more than one person, for example, in one case someone with primary responsibility for new working-age claims and someone with specific responsibility for assessing and processing SMI.

The interviews were undertaken using a topic guide that identified key issues for discussion, but ensured that respondents were able to range widely and raise issues without constraint and in the order that they determined. The topic guides had a series of prompts to check if issues not raised unprompted were or were not salient.

The interviews lasted between 45 and 60 minutes. In some cases respondents provided follow up statistics or documentation and in all cases the researchers were free to go back to respondents to check information or seek clarification.

All the interviews were read several times and the analysis of the material organised around key issues that were identified as important by the Phase 1 study, or by other research on the management of arrears and forbearance or raised by respondents.

References

CML (2008a). *Market Commentary, 18 December 2008*. London, Council of Mortgage Lenders. <http://www.cml.org.uk/cml/publications/marketcommentary/109> accessed 1 March 2011.

Department of Communities and Local Government, Live Table 502.

Department of Communities and Local Government (2011). House Price Index, January.

DWP (2009). *Equality Impact Assessment – Support for Mortgage Interest Changes*. London, Department of Work and Pensions.

DWP (2010a). *Equality Impact Assessment – Support for Mortgage Interest: Clarification to the treatment of Excess Payments of Support for Mortgage Interest*. London, Department of Work and Pensions.

DWP (2010b). *Equality Impact Assessment – Support for Mortgage Interest: Planned change to the standard interest rate at which Support for Mortgage Interest is paid*. London, Department for Work and Pensions.

Ford, J. and Wilcox, S. (1992). *Reducing Mortgage Arrears and Possessions: An Evaluation of the Initiative's*. York: Joseph Rowntree Foundation.

Kempson, E., Ford, J. and Quilgars, D. (1999). *Unsafe Safety Nets*. York: Centre for Housing Policy.

Munro, M., Smith, S. and Ford, J. (2010). *An evaluation of the January 2009 arrangements for Support for Mortgage Interest*. London: Department for Work and Pensions.

Wallace, A. and Ford, J. (2010). Limiting Possessions? Managing Mortgage Arrears in a New Era, *International Journal of Housing Policy*, Vol. 10, No. 3 pp. 133–155.

Wilcox, S., Wallace, A., Bramley, G., Morgan, J., Sosenko F., and Ford J. (2010). *Evaluation of the Mortgage Rescue Scheme and Homeowners Mortgage Support Download*. London: Department of Communities and Local Government.

This report is the second of two, to explore the impact of a range of temporary measures introduced in 2009 and 2010 to provide additional help to owner occupiers with a mortgage who were eligible to claim out-of- work benefits.

The Department for Work and Pensions commissioned the University of York to explore the responses of lenders, money advisers, 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).

If you would like to know more about DWP research, please contact:
Kate Callow, Commercial Support and Knowledge Management Team,
Upper Ground Floor, Steel City House, West Street, Sheffield, S1 2GQ.
<http://research.dwp.gov.uk/asd/asd5/rrs-index.asp>

DWP Department for
Work and Pensions

Published by the
Department for Work and Pensions
May 2011
www.dwp.gov.uk
Research report no. 740
ISBN 978-1-84712-974-1