

# BUILDING AN EFFECTIVE SAFETY NET FOR HOME OWNERS AND THE HOUSING MARKET

The Government is looking to end temporary support measures for home-buyers during the economic and housing market downturn but there has been no progress in agreeing a more effective safety net for the future. This research evaluates the options for reform and aims to inject momentum into that process.

## Key points

- Mortgage arrears and possessions have not risen to the levels suffered in the last housing market downturn – mainly due to the sharp fall in interest rates, and temporary industry and Government support measures – but with the downturn continuing they are forecast to rise substantially.
- Mortgage arrears are a systemic feature of home-ownership. Events beyond the control of the households concerned – e.g. loss of income due to unemployment, ill-health or household break-ups – cannot be eradicated by a more prudent mortgage lending regime.
- The current UK safety net for home-buyers is patchy, and is set to be weakened further under Universal Credit and with a further decline in the take-up of mortgage payment protection insurance because of new rules governing the sales process. Voluntary take-up had already declined before the downturn so there can be no credible return to the prior policy of relying on this.
- The study highlights two key options for providing a more effective safety net while balancing out risks, responsibilities, roles and costs. The most effective would be a compulsory new partnership, similar to the Sustainable Home Ownership Partnership (SHOP) scheme. The scope and costs of the scheme could be modified by making longer-term benefit payments a charge on the borrowers' homes.
- A second option would be a new partnership structure based around continued forbearance, an auto-enrolled private insurance system and a state-backed payment system, with longer-term costs being charged to homes.

## The research

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# BACKGROUND

This project was commissioned to review recent developments concerning the home-owner safety net and to follow up the JRF Housing Market Taskforce's recommendation that further work was necessary in this area.

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## Recent developments

Although current arrears and possession levels are low by historical standards despite the continued economic downturn, much of this is due to a range of measures put in place by Government, the Bank of England and lenders, some of which are temporary and due to be removed over the next 12 to 18 months. These include:

- a bank base rate of 0.5 per cent and the Funding for Lending scheme;
- extensions to the state's Support for Mortgage Interest (SMI) regime (shorter waiting period and inclusion of higher-value homes);
- a funded mortgage rescue scheme helping owners in difficulty become tenants in their own home and thus avoid eviction; and
- extended forbearance and increased loan modifications by lenders.

Research for the Department for Communities and Local Government suggests that possession rates would have been more than 20 per cent higher without Government policy support through the temporary improvements to SMI, and lender forbearance in the form of recapitalising arrears into new loans. However, this same research also suggests that possession levels will rise over the next three years to 50,000 in 2015.

It is clear Government and lenders are aware of a likely upturn as a consequence of temporary measures ending and the continued unwinding of the credit crunch. Other issues currently dominate, though – for example Government is focused on reconfiguring SMI as part of its new Universal Credit system, and is also considering a number of options to further cut SMI expenditure in the years ahead. There are not, however, any more wide-ranging Government proposals for reforms to create a more comprehensive and effective safety net.

## Options for reform

The full report sets out a number of options for reform (including doing nothing) and focuses on two options (covered in this summary) that could provide a more effective and durable safety net for the years ahead.

The most effective scheme would be a compulsory new state and private sector partnership, along the lines of the 'SHOP' (Sustainable Home Ownership Partnership) scheme advocated in previous JRF reports – see *Developing safety nets for home-owners* (Stephens, Dailly and Wilcox, 2008).

SHOP would be a fund to which borrowers, lenders and the Government would all contribute. It would replace the state safety net and private insurance for all new home-owners and people who switch their mortgages. This could be modified by making longer-term benefit payments a charge on the property. As this would offset some of the costs of the scheme it could also extend its scope to cover support to home-owners who are on low incomes and in and out of work.

However, the SHOP scheme would need to be compulsory, not least to comply with European Union (EU) state aid requirements, and there is a question about whether this can gain the necessary political support, especially while levels of mortgage arrears and possessions remain relatively low compared to the early-1990s economic downturn. An alternative approach, which might be less politically

challenging, would be to build on recent developments in auto enrolment, as a half-way house between a voluntary and compulsory scheme.

Under this approach, new borrowers would be auto enrolled into an insurance scheme, with provisions for an opt out where they could show that they have resources of their own to weather a period of income loss. This would permit the SMI scheme to revert to a longer period of delay for households subject to the risks covered by the insurance scheme (accidents, sickness and unemployment).

While not compulsory, this approach would comply with EU competition requirements as there would be no state aid for the insurance scheme, and SMI support would not be conditional on households entering into the insurance scheme.

The authors also recommend that a measure of lender forbearance should be a structured part of the future safety net, with a period of delay before any households qualify for either insurance or state benefits.

They also recommend that longer-term means-tested support should become a charge on the owner's home, provided that there is a sufficient level of owner equity. In effect the safety net would operate as a three-stage process over time (see below). This would operate equally for the SHOP and auto enrolment/SMI options.

- Stage 1** Forbearance
- Stage 2** Insurance/benefits
- Stage 3** Benefits and charge on property

The authors do not make fixed recommendations about the duration of these stages, as there is some scope for negotiation on this between the interested parties. In particular the extent of the period of forbearance would need to be agreed with the Financial Conduct Authority (FCA) and incorporated into a revised regulatory framework for lender actions on arrears and repossessions.

The timing of the stages will also have a bearing on the costs of both the subsequent insurance and benefits scheme. A longer forbearance period would reduce both benefit and insurance costs. Equally, an earlier introduction of the third stage would substantially reduce benefit costs, as in the great majority of cases those costs would be reclaimable at a future date. This would in turn avoid the need for the fixed two-year time limit on SMI support that now applies to Jobseeker's Allowance claimants.

If longer-term SMI claims were recoverable by a charge on the property it would also be possible to consider extending SMI to households in low-paid work, rather than just for those claimants who are unemployed or otherwise economically inactive. This would remove the 'zero hours' rule proposed for SMI as part of Universal Credit and provide more effective support for home-buyers who suffer an adverse change of circumstances that leads to a loss of earnings, rather than complete unemployment or economic inactivity.

The most recent estimates for SHOP are that the combined scheme would cost £2.7 billion, of which £2.1 billion relates to the insurance part of the scheme, and £0.6 billion relates to the benefit part of the scheme. These estimates are, however, based on a short period of delay (three months) in respect of insurance costs, and no delay before benefit payments are made to households claiming as a result of an uninsurable change of circumstances. They do not make any provision for recovery of the costs for longer-term benefit claims. There is consequently potential for reducing either the overall costs of SHOP, or the complementary auto enrolment and SMI scheme.

Both approaches address the issues about balancing risks, roles, responsibilities and costs between the three parties – lenders, borrowers and government.

Under the new FSA regulatory regime there are much clearer rules to ensure prudent lending, including the requirement for robust income assessment. Under the SHOP proposal, lenders would be recharged a proportion of the scheme costs based on the claims made against the scheme by their

borrowers. Under the auto-enrolment insurance approach, the lender's prudence would be reinforced by the risk assessment required for the purposes of the insurance cover.

New rules on insurance selling (in response to the concerns about mis-selling of wider forms of payment protection insurance) prevent voluntary insurance sales when a mortgage is sold. Auto enrolment could take two forms:

- a single, centrally administered insurance scheme operated by a new public-private partnership, in a similar fashion to the insurance element of the SHOP scheme; or
- lenders could provide the insurance as an integral element of their mortgage product, so that it is not separately sold. This would leave lenders to balance the costs arising from their own practices on risk assessment, against the competitive pressures on mortgage pricing.

## Conclusion

The authors argue that action needs to be taken now so that a new structure can be put in place to underpin home-buyers and the housing market and in so doing help the wider economy.

They consider that both the SHOP and auto enrolment/SMI options have potential merits as the basis for reform. Without action and with the ending of temporary safeguards we are likely to see rising levels of arrears and possessions in the years to 2015. This in turn will act as a brake on economic recovery and any rise in consumer confidence.

Given that both the Government and lenders have now begun to consider the future it makes sense for these proposals to be developed in detail in a collaborative process with them. All parties have found it difficult to progress this agenda, not least in a period where other issues dominate and arrears and possessions remain relatively low. However there is widespread recognition that real risks remain and that action should be taken. This suggests a willingness to move forward if the right kind of framework can be put in place.

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## About the project

This was a short project built largely around the authors' existing expertise, desk-based reviews and a small number of interviews with lender and insurer trade bodies and relevant Government departments. Steve Wilcox undertook work for JRF in 2007/2008 on developing the safety net for home-owners while Peter Williams was a member of the JRF Housing Market Taskforce and previously managed the sustainable home-ownership initiative for the Council of Mortgage Lenders.

## FOR FURTHER INFORMATION

This summary is part of JRF's research and development programme. The views are those of the authors and not necessarily those of the JRF. The main report, **Building and effective safety net for home owners and the housing market: Unfinished business** by Steve Wilcox and Peter Williams, is available as a free download at [www.jrf.org.uk](http://www.jrf.org.uk)

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