Income Support and help with mortgages

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The Government proposes major changes in the way in which assistance with mortgage interest is given to recipients of Income Support from October 1995. This paper outlines these changes in the light of the current scheme and considers some of the wider implications for the housing market and the market for private mortgage insurance.

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Summary

As part of the long-term Review of Social Security, the Government has identified help with mortgage interest through income support as having potential for transfer to private provision through commercial insurance.

From October 1995 there are proposed a number of changes in the system of paying mortgage interest for those claiming Income Support:

- new borrowers will receive no help for the first nine months of the claim;
- existing borrowers will receive no help for the first two months of their claim, and only 50% for the following four months;
- instead of using the actual interest rate in the calculation of mortgage interest rates, a standard rate will be used.

The regulations to achieve these changes - the Income Support (Housing Costs) Regulations 1995 - have been the subject of a consultation exercise and their final form is awaited.

This paper examines the proposed changes, details some of the background to them and considers their possible impact, particularly in the context of the wider housing market, on arrears and repossessions and on the market for private mortgage insurance.

I Background

A. Existing rules

Currently, income support claimants receive help with mortgage interest payments, although not capital payments. Help is also given with interest on essential home repairs, some service charges for leaseholders and some other housing costs.

For claimants under 60, help is restricted to 50% of interest payments for the first 16 weeks of the claim. Thereafter full help is available. Those aged 60 and over get 100% of their interest from the outset. However, for all claimants, there is an overall limit on the amount of capital on which interest payments will be met. This "cap" is currently £100,000. In addition, there are rules which can prevent excessively high housing costs being met - for example, where the home is unnecessarily large or is in an unnecessarily expensive area.

Deductions are made from benefit where a "non-dependant" lives with the claimant. This is someone - a grown-up son or daughter for example - who is not a member of the "family" for income support purposes, and who is consequently expected to make a contribution to housing costs. The level of deduction varies with the age and circumstances of the non-dependant.

B. Rising costs of provision

The Government describes current assistance as "a growing burden on Social Security programme expenditure"[1]. It is currently estimated at £1.1bn a year. This has risen from £31m in 1979, and has doubled since 1990.

The table overleaf shows how this has grown over the last 7 years:

[1]*Memorandum to the Social Security Advisory Committee Income Support for Mortgage Interest*, DSS, February 1995. Appended to SSAC Press Release, *Income Support for Mortgage Interest*, 10.2.95.

Income Support - Mortgage interest payments
Great Britain

	Claimants (000s)	Expenditure (£m)	Annual Average cost per claimant (£)
1988	300	286	950
1989	281	353	1,260
1990	310	554	1,790
1991	411	949	1,900
1992	499	1,143	2,290
1993	556	1,222	2,200
1994	548	1,082	1,970

Source: DSS Press Notice 30 Nov 1994 *Peter Lilley curbs soaring housing costs*

Official estimates of the amount to be saved as result of the proposed changes have not yet been made available. The response in PQs has been that the financial effects will depend on the final details of the scheme[2]. However, the Institute of Housing reckons the proposed measures will result in savings of around £200 million per year in the longer term[3].

Factors attributable to the movement of these costs include changing interest rates, unemployment, house price inflation and other social changes, such as rising rates of marital breakdown.

C. Recent rule changes

Help with housing costs for owner occupiers was provided under the Supplementary Benefit Scheme and was incorporated into its successor, income support, in 1988. The "16 week rule" restricting initial help to 50% was introduced in January 1987 in order to "reduce the discouragement for owner occupiers to return to work"[4] and to strike a "reasonable balance between the borrower, the lender and the taxpayer"[5].

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[2]HC 9 May 95 c392W

[3]Response of the Chartered Institute of Housing *Income Support for Mortgage Interest* March 1995

[4]Green Paper, *Reform of Social Security*, Cmnd 9518, June 1985, para 2.92.

[5]DSS Press Notice 92/58, 27 April 1992.

More recent changes have included the following:

- Since May 1992, income support mortgage interest payments have been normally been made directly to the lender from week 17 of the claim. This was part of an agreement with mortgage lenders, who in return confirmed that they would not repossess in cases where mortgage interest payments are covered by income support[6]. (For the earlier weeks 50% is payable to the claimant/borrower)

- In April 1993, a loan capital limit of £150,000 was introduced following criticism of certain highly publicised cases where very high amounts of mortgage interest had been met by income support. The Social Security Advisory Committee urged the Government not to apply this cap to existing borrowers unless assurances could be given by the insurance industry that they could gain cover[7]. The Government rejected this, although they did accept that loans to adapt a home for a disabled person should be exempted. The cap was reduced to £125,000 from April 1994, and further to £100,000 from April 1995.

- In May 1993, rules were introduced to prevent extra help being given in cases of so called "upmarketing" - where a claimant already on benefit takes out an increased mortgage, for example to move into a more expensive home. Income support will meet only the original loan commitment. There are some exceptions for the special needs of disabled people, for essential repairs and improvements and for loans resulting from the need for separate sleeping accommodation for children of different sexes aged 10 or over.

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[6]See announcement by Norman Lamont MP, then Chancellor of the Exchequer, HC Deb 19.12.91 cc 453-4.

[7]*The Income Support (General) Amendment No. 3 Regulations 1993 Report by the Social Security Advisory Committee*, Cm 2272, July 1993.

II The Proposed Changes

A. Announcement of Changes

The new restrictions were first announced by the Chancellor, Kenneth Clarke, in the 1994 Budget Statement[8]. Further information was given the following day by the Secretary of State for Social Security, Peter Lilley[9]:

> Taxpayers pay the mortgage interest of people on income support. Over the past 15 years, that expenditure has risen from £31 million to more than £1 billion, and the scheme has major drawbacks. Until I imposed a cap, it covered any size of mortgage - from cottages to castles. Next April, I intend to reduce that cap to £100,000. The generosity of the scheme for those out of work can create huge disincentives to move back into work - but to extend help with mortgages to people in work would be immensely costly.
>
> Since income support cover is paid direct to lenders, the scheme is simply bailing them out for their bad lending practices. The present system also discourages individuals from taking out private insurance and dissuades lenders from insuring all their loans. None the less, private insurance has spread significantly. I believe that insurance of mortgages should become the norm.
>
> For anyone taking out a loan after 1 October next year, we shall pay income support for mortgage interest only after the first nine months on benefit. I believe that insurance for that nine-month period will be readily available. I expect that many lenders will incorporate it in their loans at modest cost.
>
> Existing mortgage holders qualify at present for 50 per cent. of their interest payments for the first 16 weeks - but that money is paid to borrowers, and they do not always pass it on to the mortgage lender. In practice, most people who lose their job and who are unable to meet their mortgage payments return to work within a few months. Most private policies make no payments in respect of the first few weeks. Lenders rarely repossess in such circumstances, even when the borrower is not covered by income support. I propose that no payments will be made for the first two months for existing mortgage holders who start an income support claim. For the next four months, the payment of 50 per cent. of mortgage interest currently made to the borrower will be made direct to the lender. Thereafter, mortgage interest will be paid in full, as at present.
>
> We shall consult the Social Security Advisory Committee, mortgage lenders and insurers about circumstances that cannot be covered by insurance. I am confident that the insurance market will respond, that lenders will behave responsibly, and that sound lending will ultimately contribute to a healthier market.

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[8]HC Deb 29.11.94 c1088.

[9] HC Deb 30.11.94 c 1207.

A detailed description of the Government's intentions was provided in the DSS's Memorandum to the Social Security Advisory Committee[10]. This explained the reasons for the changes in the following terms:

> Income Support cannot cover where one of a couple has lost work but the other is still working and unemployment benefit does not act as a replacement for previous earnings, those people with modest savings, those with small company pensions, or even many people with redundancy payouts. In fact nearly 70% of all home owners would not qualify for Income Support if they became unemployed because of capital, income, or a working spouse.
>
> The Government believes that it is not sensible to carry on with these arrangements. Responsibility for the housing market should lie with those best placed to respond effectively - borrowers, lenders and insurers. It is the case that lenders and insurers would have had to review their strategies for the long-term in any event. The challenges of a changing labour market, a fixed low-inflation economy and borrowers' perspectives, shaped by the recent shake-out in the housing market, all need to be considered.
>
> The Government believes that mortgage protection insurance in particular, can provide an effective and comprehensive substitute to Income Support. It has framed the proposals here in such a way as to encourage take-up of private provision by borrowers. It also intends to work with lenders and insurers to ensure, as far as possible, that good quality and affordable insurance is available. The Government has initially recognised one limit, that insurers cannot provide cover indefinitely, and has reflected this in the proposals so that the State is there in the long-term to support those in need.

B. The Regulations

The Social Security Advisory Committee (SSAC) was asked to consider the proposed changes to mortgage interest paid as part of income support and the introduction of a standard rate of mortgage interest. The Committee invited organisations and individuals with views on the proposals to make representations to them. Initially the consultation period was to end on 17 March 1995, but this was extended to 31 March 1995[11].

The draft regulations[12] were published by the SSAC on 10 March. They set out amendments to the Income Support (General) Regulations 1987 (No. 1967) in line with the proposals already announced. This includes revoking Schedule 3 to the 1987 Regulations and the proposed regulations include a re-scheduling of this part of the old rules.

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[10]Op Cit

[11]SSAC Press Notices 10.2.95, 10.3.95

[12]Social Security *The Income Support (Housing Costs) Regulations 1995*

C. The Main Proposals

From April 1995:

- the upper limit of loan capital supported is reduced from £125,000 to £100,000.

From 2 October 1995:

- new borrowers will receive no help for the first 39 weeks of the claim;
- existing borrowers will receive no help for the first 8 weeks of their claim, and only 50% for the following 18 weeks. The full rate becomes payable from week 27;
- instead of using the actual interest rate in the calculation of mortgage interest rates, a standard rate will be used;
- existing claimants as at 1 October will receive transitional protection;
- people aged 60 and over will not be subject to the new restrictions. The Government is consulting on whether other groups may need additional safeguards.

In terms of housing costs to be covered, the new regulations largely mirror existing provision, with one notable exception. Currently, income support payments can include an element for interest on loans for major repairs and improvements necessary to maintain the fabric of a dwelling[13]. Under the proposals these payments would be made only where the repairs are necessary to maintain the dwelling's fitness for occupation.

Also newly introduced is the equal treatment of those purchasing a rented home under the "right to buy" with other people moving from rented accommodation. (Both groups will now have their housing costs restricted to their previous rent liability. Currently this restriction is not applied to those purchasing under the right to buy).

The standard rate of mortgage is being introduced primarily to simplify the operations of the Benefits Agency in calculating eligible mortgage interest, and particularly variations when interest rates change. Operating the current rules of reflecting all changes in interest rates and

[13]Income Support (General) Regulations 1987 Sch 3(1)(b)

variations between lenders and from one loan to another has, according the DSS, been the single most problematic part of Income Support mortgage interest. It is intended that the rate should be set at, or around, the average rate of interest and reviewed periodically. The Government has stated that the move to a standard rate is not intended to withdraw money spent in this area[14].

People who would lose as a result of the move to a standard rate would be those who have a mortgage with an interest rate above the standard set. The DSS argues that the majority of the most significant losers will be those who have non-standard advances, typically in addition to the main mortgage, for repairs or improvements. As insurance is often offered with these loans, the government proposes not to give these losers special treatment.

Those who might gain would be people whose actual mortgage interest rate was lower than the standard. This could include people with a deferred mortgage product or special interest discounts (usually as first time buyers). The Government does not think that such people should benefit from the change and proposes that the actual cost of mortgage interest will be calculated for these claimants.

D. Reactions and comment

Reactions to the proposed benefit changes have largely centred around the question of the availability, or likely future availability, of comprehensive insurance products to replace the payments formerly available through Income Support. Concern has particularly been expressed about the availability of suitable insurance products for groups such as the self-employed, contract workers, people with disabilities or health problems who could find themselves excluded from insurance because of a pre-existing medical condition or because of the (current) non-availability of suitable insurance cover (This is discussed in more detail in Part IV on page 16) There has also been some questioning of the desirability of a standard rate of interest, which would disadvantage borrowers paying at a higher rate.

The National Association for Citizens Advice Bureaux' submission to the SSAC[15] expressed profound concern about the scope and early timescale of implementation of the proposals:

> The CAB Service is deeply concerned at the Government's proposals to curtail the amount of income support help for home owners and so weakening this crucial safety net. In our view the inevitable consequence of this proposal will be an increase in repossession among home-owners in receipt of income support. Moreover it is of concern that such significant changes can be implemented through secondary legislation, without detailed Parliamentary scrutiny.

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[14]DSS Memorandum to the SSAC *Income Support for mortgage interest* Feb 1995

[15]NACAB March 1995

> As paragraph 36 of the consultation document explains, these changes 'signal in the clearest terms that the State, even in the long term, will not take full responsibility for borrowers' commitments and indemnifying (sic) them for all changes in circumstances - shifting away from paying individual housing costs.'
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> .
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> .
>
> The CAB Service is profoundly concerned at the scope of the proposals under consideration. Moreover the speed with which they are to be implemented makes it unlikely that radical changes to mortgage protection policies and to lenders' forbearance arrangements will be in place in time to prevent a significant increase in repossessions.
>
> ISMI is already a very tightly targeted safety net. Indeed the capital limit of £3,000 has not been increased for over ten years. Given ISMI's limited scope, there is clearly an important role for good quality private insurance to play, although the CAB Service has many reservations about the current product. However, given the inevitable unpredictability associated with private insurance, both as to the affordability of the premiums and the scope of the cover, the CAB Service believes it is essential that the current ISMI provisions are retained.
>
> [ISMI - Income Support for Mortgage Interest]

The Association of British Insurers is less sceptical about the role of private insurance to replace income support for mortgage interest, although it too points out that the benefit system and private insurance are to a certain extent complementary[16]:

> At present there is a healthy market for Mortgage Payment Protection insurance. About fifteen insurers, ranging from specialist creditor insurers to large national composite insurance companies, are in the market. Currently around a third of all home buyers take out policies each year, premiums annually totalling around £250 million. Mortgage Payment Protection insurance covers a different set of circumstances from income support, although obviously there is also a significant overlap. Typically policies will pay out, after the 60 (or 90) day excess has passed, for twelve months, subject to a maximum monthly payment of £1,000. Unlike income support, there is no savings test, and the circumstances of other members of the family are not taken into account.
>
> It is reasonable to expect that as a result of the recently-announced changes in income support, more people will take out mortgage protection insurance. This factor, combined with falling unemployment, should reduce the cost of such insurance. If more people take out Mortgage Payment Protection policies, then more people will be better protected against the consequences of unemployment and disability given the limited coverage of Income Support.
>
> Insurance protects against unforeseen events, and some categories of people for whom unemployment is not unforeseeable may have difficulty in buying Mortgage Payment Protection policies. However, most such people would also have difficulty in obtaining mortgage loans as lenders lend only to those people who they believe are able to repay their loans. There are likely to be very few people who will meet a mortgage lender's eligibility criteria but who will not be eligible for Mortgage Payment Protection insurance. Lenders and

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[16] ABI *Mortgage payment protection insurance and proposed changes to income support benefit for mortgage interest: An Overview* 3 February 1995

> insurers generally work together to create Mortgage Payment Protection insurances modelled around a Lenders particular client base. Policies already cover contract workers and self-employed people, and insurers will be reviewing their policies in the light of the changed market circumstances. Insurers will explore with mortgage lenders the full implications of the new arrangements with a view to providing effective protection for a reasonable premium.

In their submission to the SSAC the Child Poverty Action Group (CPAG) set out their objections to the proposed changes and belief that a more comprehensive system of benefits should be available for mortgage holders, not just those on income support[17]:

> 1.1 CPAG opposes the proposals to disentitle existing borrowers to any help with housing costs for the first 8 weeks of a claim for income support (IS) and to disentitle new borrowers, after 2 October 1995, to any help for the first 9 months of an IS claim. For ease of reference, help with housing costs will be referred to in this submission as ISMI (income support mortgage interest), even though it is not just mortgage interest which is affected.
>
> 1.2 Similarly, CPAG opposes the proposal to award ISMI according to a standard rate of interest (rather than the actual rate an individual borrower has to pay) and some of the other proposed changes of detail.
>
> 1.3 Indeed, far from reducing existing help, CPAG believes that what is required is improved assistance for home owners who fall into difficulty. In this connection, CPAG would like to see the introduction of a comprehensive mortgage benefit for all those on low income, whether in or out of work, to mirror the existing provision of housing benefit (HB) for those on low income living in rented accommodation. The recent reductions of mortgage interest tax relief, and any further reduction, could be used to fund the new benefit.
>
> 1.4 CPAG also proposes that the rule, introduced in 1987, whereby most claimants only get 50% of their mortgage interest paid for the first 16 weeks of a claim, should be abolished.
>
> 1.5 CPAG would also like to see an amendment to the rule whereby a claimant with a working partner is only entitled to IS (and therefore to ISMI) if the partner works less than 16 hours week. IS should be payable where the partner is working less than 24 hours a week, in line with the proposal in the Jobseekers Bill. This will reduce the current disincentive for a partner to continue in full-time work.
>
> 1.6 CPAG's objections to the Government's proposals are based both on principle and on practical considerations. The principle is that the state should help home owners on low income whenever they fall on hard times. However, if the Government is intent on promoting a diluted version of this principle, it should nevertheless not introduce its proposed changes until and unless it is absolutely satisfied that the insurance provision it wishes to foster is actually available to all who are likely to need it, in comprehensive and affordable form. CPAG believes that it is fundamentally wrong for the Government to introduce such radical and far-reaching measures simply in the hope, or even in the belief, that the insurance market will fill the gaps it is deliberately creating. All the available evidence is that the market will not be able to, or will not wish to, respond adequately.
>
> 1.7 People falling into categories which will not, or may not, be able to obtain such comprehensive and affordable insurance should be exempted from the proposals. Examples of such categories of people are carers, disabled people, part-time workers and contract workers. There may well be others. The onus should be on the Government to satisfy itself that particular groups are readily insurable, not for them to prove a negative.

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[17] CPAG Submission to SSAC on the IS (Housing Costs) Regulations 1995, April 1995

> 1.8 The Government should also ensure that provision of mortgage protection insurance is properly regulated.

The Government response to such observations have been fairly robust, as the following extract from a speech by The Parliamentary Secretary for Social Security, Roger Evans, shows[18]:

> Whilst the Government remains the insurer of last resort of the housing market, current arrangements do not help borrowers, lenders or Government adequately. Working together, we can produce a better scheme that will benefit all.
>
> It is easy to forget that nearly 70% of all homeowners would not qualify for Income Support if they became unemployed either because they have a working partner or their savings are above the capital threshold. Unless they already have private insurance they will have no protection when it is needed.
>
> Our proposals will act as a catalyst to ensure that eventually all homeowners are encouraged to protect themselves should they be unable to meet their mortgage repayments. New policies are emerging and some are available for only £12 a month on the average mortgage. I believe that the proposals will encourage take up of mortgage insurance, spreading the risk and thus substantially reducing the cost.
>
> However, we recognise that transferring support to private provision cannot be achieved by Government in isolation. A successful scheme that benefits all will succeed only by Government, lenders, insurers and borrowers working closely together.
>
> Furthermore, we hope that a result of this partnership will be a guide to good practice - a borrowers framework - which will help the public generally understand their rights and obligations in borrowing before they buy homes.
>
> We will carefully monitor the scheme once it is introduced to ensure the proposals meet the needs of all.

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[18] Roger Evans addressing the Council of Mortgage Lender's conference in London - DSS Press Notice 3 April 1995

III Mortgage arrears and repossessions

Statistics (since 1980) on the number of loans over six months in arrears and on repossessions are set out in the table below:

Table 1 UK mortgage arrears and repossessions

	Number of mortgages at end period	Properties taken into possession during year		Mortgages in arrears (end period): 6-12 months (a)		1 year & over	
	number	number	% of mortgages	number	% of mortgages	number	% of mortgages
1980	6,210,000	3,480	0.06%	15,530	0.25%	na	na
1981	6,336,000	4,870	0.08%	21,540	0.34%	na	na
1982	6,518,000	6,860	0.11%	27,380	0.42%	5,540	0.08%
1983	6,846,000	8,420	0.12%	29,440	0.43%	7,530	0.11%
1984	7,313,000	12,400	0.17%	48,270	0.66%	9,510	0.13%
1985	7,717,000	19,300	0.25%	57,110	0.74%	13,120	0.17%
1986	8,138,000	24,090	0.30%	52,080	0.64%	13,020	0.16%
1987	8,283,000	26,390	0.32%	55,490	0.67%	14,960	0.18%
1988	8,564,000	18,510	0.22%	42,810	0.50%	10,280	0.12%
1989	9,125,000	15,810	0.17%	66,800	0.73%	13,840	0.15%
1990	9,415,000	43,890	0.47%	123,110	1.31%	36,110	0.38%
1991	9,815,000	75,540	0.77%	183,610	1.87%	91,740	0.93%
1992	9,922,000	68,540	0.69%	205,010	2.07%	147,040	1.48%
1993	10,137,000	58,540	0.58%	164,620	1.62%	151,810	1.50%
1994	10,410,000	49,190	0.47%	133,700	1.28%	117,110	1.12%
1992 H1	9,840,000	35,750	0.36%	191,280	1.94%	113,860	1.16%
1992 H2	9,922,000	32,790	0.33%	205,010	2.07%	147,040	1.48%
1993 H1	9,998,000	31,780	0.32%	191,560	1.92%	158,000	1.58%
1993 H2	10,137,000	26,760	0.26%	164,620	1.62%	151,810	1.50%
1994 H1	10,375,000	25,000	0.24%	153,310	1.48%	142,230	1.37%
1994 H2	10,410,000	24,190	0.23%	133,700	1.28%	117,110	1.12%

Notes: (a) figures for loans 6-12 months in arrears prior to the end of 1982 should be treated with caution.

Sources: *Council of Mortgage Lenders "Housing Finance No. 25", February 1995, Table 11*

The figures cover members of the Council of Mortgage Lenders (CML) who account for over 90% of all mortgages. Data are collected from the largest of the CML members and grossed up to represent CML members as a whole; earlier figures have been grossed up to be consistent with the current wider membership of the CML. Properties taken into possession include those voluntarily surrendered. The figures have been rounded to the nearest 10 to avoid a spurious impression of accuracy. Properties in possession are not also counted as loans in arrears. Because arrears are calculated as a multiple of current monthly repayments, changes in interest rates will affect the number of mortgages in arrears. This applies particularly to 1991 when the sharp reduction in interest rates increased the level of arrears.

Faced with record repossession levels in 1991 and widespread predictions that this trend would be sustained throughout 1992, in December 1991 the then Chancellor of the Exchequer announced a package of measures aimed at reducing the number of repossessions.[19] The most important element of this package involved an undertaking by the Government to legislate to ensure the direct payment of income support for mortgage interest (ISMI) to lenders in return for a commitment by lenders not to repossess the homes of people in receipt of ISMI;[20] lenders believed that this legislation was necessary to prevent the "leakage" of ISMI payments into other forms of spending. The *Social Security (Mortgage Interest Payments) Act 1992* received Royal Assent on 16 March 1992 and the direct payment of mortgage interest began in June of that year.

Direct payments, as well as reduced rates of interest and a willingness on the part of lenders to reschedule payments and accept reduced amounts from borrowers (eg where they have had to accept lower paid employment), assisted in reducing the number of mortgage repossessions to 49,210 in 1994 from 75,540 in 1991; the number of borrowers with long term arrears (6-12 months) also fell from 164,620 at the end of 1993 to 133,700 at the end of 1994. However, the CML has predicted that arrears and repossessions will increase again as a direct result of the proposed cuts to ISMI:[21]

> As a consequence of the proposed changes, mortgage arrears will rise and possessions are likely to increase in 1996. This is the inevitable conclusion to be drawn from the fact that less support will be available to mortgage borrowers if they get into difficulties; higher levels of arrears are bound to accumulate. Lenders will continue to try to assist those of their borrowers who fall into difficulties as far as possible, but while they can reschedule payments and show flexibility they cannot solve the underlying problem of insufficient income when people lose their jobs.

The Government has been accused of reneging on the agreement reached with mortgage lenders in 1991. CML members have threatened to restart possession proceedings against income support claimants if cuts in assistance are implemented.

Organisations dealing with the homeless, such as Shelter and Shac (the London housing aid centre), have pointed out that almost 1,000 households a week are currently losing their homes through repossession and are concerned at the effect of any increase in repossessions on levels of homelessness. It could be argued that savings in public expenditure arising from cuts in mortgage assistance may be offset by the cost to local authorities of rehousing repossessed families or their displacement into the private rented sector; figures on the comparative cost of providing financial support for housing costs through income support and housing benefit are given in the table below:[22]

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[19] HC Deb 19.12.91 cc453-454

[20] for information on other elements of the package see Library Research Note 92/96, *Mortgage Rescue Update*

[21] CML News Update, February 1995, "Decline in repossessions threatened by income support changes"

[22] *Roof Briefing*, February 1995

Repossession costs you more

	1991	1992	1993	1994
Income support mortgage payments				
Claimants ('000s)	411	499	556	548
Weekly average cost (£)	44.22	44.03	42.32	37.98
Total cost (£m)	998	1,161	1,222	1,056
Housing benefit for private tenants				
Claimants ('000s)	674	838	1,004	n/a
Weekly average cost (£)	37.20	43.20	48.58	n/a
Total cost (£m)	1,304	1,882	2,536	n/a

Source: DSS and Housing Finance Review statistics prepared by Steve Wilcox. Income support figures are for May, except 1994 which are for February

The Government's response to the predicted rise in repossessions is set out in the following Parliamentary Answer:[23]

Mortgage Interest

> **Mr. Raynsford:** To ask the Chancellor of the Exchequer, pursuant to his answer of 13 February, *Official Report,* columns 479-80, what advice he has received from the Council of Mortgage Lenders as to the likely effect of the proposed changes to income support towards mortgage repayments on the level of repossessions.
>
> **Mr. Roger Evans**: I have been asked to reply.
>
> The Council of Mortgage Lenders has advised that it expects the number of repossessions to increase as a result of the proposed changes. We are listening carefully to its concerns but believe that these proposals will result in the development of comprehensive quality insurance and will provide better protection for all home owners, not just those who currently get help from income support mortgage interest.

The likely availability and coverage of private insurance is discussed in the following section.

Recent research by the Joseph Rowntree Foundation (JRF) into the role of housing in the British economy[24] concluded that, "dealing with arrears and possessions is still a matter of major priority and will remain so for several years". The report recommended several areas where it was felt the Government should re-emphasise existing policies and develop new initiatives, ie:

- reconfirm to lenders their commitment to fund mortgage interest payments for those on income support;

[23] HC Deb 22.2.95 c.196W

[24] JRF *A Competitive UK Economy: The Challenges for Housing Policy,* June 1994

- review and modify DSS restrictions that currently exacerbate mortgage arrears;
- remind lenders of the 1991 agreement that households on income support with full interest paid direct should not have their homes repossessed;
- revitalise the "mortgage rescue" process allowing those with long-term mortgage arrears to reduce the share of their home which they own or to become tenants of their properties;
- devise, when repossession is pursued, a better framework of advice for borrowers and a more effective system of liaison between lenders and councils to preclude homelessness;
- consider including a mortgage benefit for owners similar to housing benefit for renters.

IV Private insurance

The Government believes that gap left by the proposed cuts in ISMI should be filled by mortgage protection insurance:[25]

> The Government believes that mortgage protection insurance in particular, can provide an effective and comprehensive substitute to Income Support. It has framed the proposals here in such a way as to encourage take-up of private provision by borrowers. It also intends to work with lenders and insurers to ensure, as far as possible, that good quality and affordable insurance is available. The Government has initially recognised one limit, that insurers cannot provide cover indefinitely, and has reflected this in the proposals so that the State is there in the long-term to support those in need.

Mortgage payment protection insurance provides protection for people who have mortgages in the event that they are made unemployed through involuntary redundancy or become disabled so that they are unable to work. Payment is usually made in the form of a fixed monthly premium in exchange for which the borrower receives cover for their monthly repayment, plus other mortgage related expenses such as endowment policy premiums and household insurance premiums.

Most mortgage borrowers are advised about payment protection when they take out a new loan. In recent years lenders have given greater prominence to these products; this is, perhaps, not surprising given that they offer lenders extra security and generate income via commission fees.

Currently cover is sold by insurers on a block basis through each mortgage lender, as a result there is a single premium rate with the insurer either accepting or rejecting each individual applicant. Insurance has been traditionally sold at the time, or shortly after, people take out a new mortgage; however, the Association of British Insurers (ABI) believes that alternatives are emerging which will enable existing mortgage holders to buy insurance directly from insurance companies.[26] In a speech to the IBC Financial Focus Conference on 7 June 1995, the Deputy Director General of the ABI stated that high quality insurance cover is available and also that insurance companies are expanding their range of policies to meet the growing and changing needs of customers.[27] A postal survey of 151 mortgage lenders, conducted by the DoE, found that at the end of 1993 14 per cent of loans where cover was available had an associated mortgage protection policy.[28]

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[25] Memorandum to the Social Security Advisory Committee: Income Support for Mortgage Interest, para 9, 10.2.95

[26] ABI's response to the proposed changes to ISMI, para 3.4, 3.2.95

[27] ABI Press Release "Expanding market for mortgage payment protection insurance will benefit homeowners" 7.6.95

[28] DoE *Mortgage Arrears and Possessions; perspectives from borrowers, lenders and the courts,* 1995, p.61

A. Comparisons with ISMI

Under current arrangements ISMI eligibility is not restricted on the basis of a claimant's age. Private cover is generally not available to people aged over 60; other individuals may be excluded owing to the nature of their employment or for health reasons (see below).

Claimants with savings of £8,000 or more do not qualify for ISMI and those with savings of between £3,000 and £8,000 have a reduced entitlement. Claims under private polices are not affected by a policyholder's savings and will usually cover both the interest and capital payments on a mortgage for a given period.

ISMI is not payable where one partner is working more than 16 hours a week. In contrast, mortgage protection policies which cover couples will pay out the pre-determined proportion of the policy benefit for which ever partner is without employment. These extra benefits are reflected in the premiums charged.

Most mortgage protection policies typically include a waiting period before a person can claim on a policy which has been newly taken out. There may also be an "excess" period of between 60-90 days during which the policy holder cannot make a claim for unemployment or disability. The justification for these exclusion clauses is:[29]

> Many people suffer from temporary disabilities or become unemployed only to find a job again quite quickly. Were insurance to cover these temporary cases of disability and unemployment the number of claims would increase very substantially, so worsening the underwriting result and increasing the claims handling costs for insurers. These in turn would lead to substantially increased premiums. Moreover, quite a number of people have the financial resources, including for instance redundancy payments, to carry them through a brief period out of work.

Although claimants only receive ISMI to cover 50 per cent of their interest payments for the first 16 weeks of the claim, there is no equivalent "excess" period under the current ISMI system. In addition, policy holders may find that their insurers will not pay out if their particular circumstances are covered by an exclusion clause.

Despite the fact that private cover offers higher payments and an absence of restrictions on savings or other income, the current state system would appear to be less restrictive in terms of eligibility of persons, eligibility of claims and further exclusions. UBS Limited notes:[30]

> Private insurers are driven by their need to make a reasonable return; it is unrealistic to expect a private system to be perfectly compatible with the broader social objectives of a social security system.

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[29] Ibid, para 2.2

[30] UBS Limited 17.11.94 "An end to income support for mortgage interest payments - what implications for the housing market?"

Lenders interviewed as part of the DoE's study of mortgage arrears and possessions did not see mortgage protection policies as a viable alternative to the safety net of mortgage interest direct. They commented that "borrowers at greatest risk rarely met the acceptance criteria" and also "insurers have tightened up very considerably and used every clause they could to avoid paying out."[31]

B. Eligibility

The issue of whether certain groups of people will be ineligible for private mortgage protection insurance has generated considerable concern. The Government has committed itself to retaining the current ISMI arrangements for people in receipt of the pensioner premium and is consulting over whether there are other groups, eg the sick and disabled, who may need additional safeguards. The ABI is of the view that if a person satisfies a mortgage lender's criteria for obtaining a mortgage they will generally be eligible for mortgage insurance provided they are between 18 and 60 and are working, for remuneration, at least 16 hours a week; however, the ABI does accept that special considerations apply to certain categories of people including the self-employed, contract workers, and people with disabilities and health problems.

The self-employed present problems to the mortgage insurance industry because of the difficulty in determining whether they have permanently ceased trading or are just suffering from a temporary absence from work. Therefore, those companies which will provide cover for the self-employed tend only to pay claims when it can be clearly demonstrated that they have permanently ceased work. The Trade Union Congress (TUC) recently carried out a survey[32] of ten insurance companies who provide mortgage protection insurance and found that they all offered sickness and accident cover to the self-employed but two would not cover them against unemployment. Five of the companies would only accept financial insolvency, bankruptcy and liquidation as proof of unemployment; two of the policies implied that they would seek "satisfactory proof" of unemployment but gave no guidance on what proof this might be, the remaining policy required the claimant to show "you have stopped work because you could not find enough work to meet all your reasonable business and living expenses and that the unemployment is not normal or seasonal in your line of work", arguably even this clause leaves some room for interpretation.

Contract workers present insurers with comparable problems to those of the self-employed. In relation to unemployment, the question arises as to whether the contract has reached its natural expiry date or whether it has been terminated prematurely. None of the companies in the TUC's survey[33] offered cover to people on fixed term contracts of less than 12 months.

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[31] DoE *Mortgage Arrears and possessions; perspectives from borrowers, lenders and the courts*,1995, pp 61-2

[32] TUC *Mortgage Payers at Risk*, 9.2.95

[33] Ibid

In respect of part-time workers, although the ABI claims that they are treated, for mortgage protection purposes, as being in full-time employment if they work for more than 16 hours per week,[34] the TUC survey found that companies would only cover people who had been employed for more than 16 hours per week for the previous six months; two extended this period to 12 months and one policy required people to have been in employment of least 30 hours a week.

Whilst mortgage protection insurance may be available for people with disabilities and health problems, claims may not be made for situations arising from pre-existing health problems. It has been suggested that this makes insurance largely meaningless for a great many people. The TUC survey found that many private policies do not cover borrowers aged over 55 years or, if they did, they charged substantial increases in premiums for people near retirement. The Chartered Institute of Housing has recommended that protection from the proposals should start at 55 years, rather than 60.[35]

The ABI accepts that "some categories of people for whom unemployment is not unforeseeable may have difficulty in buying mortgage protection policies", but argues that "most such people would also have difficulty in obtaining mortgage loans as lenders lend only to those people who they believe are able to repay their loans."[36] The TUC's estimate of the extent of possible exclusion from private insurance is set out below:[37]

> Some idea of the scale of the exclusion can be seen from the following profile of excluded groups. However, it should be noted that these figures refer to *individuals* rather than households, so it does not take account of households which might, for example, contain someone working full time and someone working part time. It is therefore a measure of individuals who would find it difficult to get insurance rather than households.
>
> - about 3.3 million people work as self employed, and 0.35 million are self employed part time with usual weekly hours of less than 16 hours a week;
> - nearly half of all part time workers - 2.6 million - have usual hours of less than 16 hours:nearly 800,000 work less than 8 hours;
> - about 1.6 million workers have temporary contracts: half are part time, mainly in agency, casual, or seasonal employment and nearly 900,000 are full time temporary workers mainly with fixed term contracts;
> - about 5.35 million people in work (self employed, employees, trainees, unpaid family workers) are over 50: 3.55 million work full time;
> - other groups which may face difficulty are those on government training schemes (300,000) and unpaid family workers (144,000).

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[34] ABI's response, para 5.7

[35] CIOH response to the Government's proposals on ISMI, March 1995

[36] Ibid, para 7.3

[37] TUC *Mortgage Payers at Risk*, 9.2.95, p.12

> Taken together, these groups total between 7 and 10 million individuals but this is clearly far too large in practice. Some of these could not realistically take on a mortgage in the first place because earnings are too low, or do not need mortgage cover because they rent or own a house outright. The number of *households* affected will be much less than the number of individuals. Some overlap has to be allowed for. Even so, it is clear that very large numbers - millions rather than thousands - will find it difficult to get mortgage cover.

Although eligible for mortgage protection insurance some householders, whether due to genuine hardship or not, may opt not to pay the additional cost of premiums and will prefer to "take the risk". However, if mortgage lenders decide to make the approval of a mortgage application subject to appropriate insurance cover this option will not be available.

C. Exclusion clauses

Those people who are eligible for mortgage protection insurance may experience problems in making a claim if their circumstances are covered by one of the many exclusion clauses in their policies.

As well as standard exclusions relating to resignation, voluntary redundancy, retirement and failure to look actively for another job, the TUC's survey of insurance policies identified the following exclusions:

- all the policies included an "excess" period during which they will not pay out on a claim (see above);
- all the policies would not pay out if the claimant was aware of impending unemployment when they took out the policy;
- all the policies excluded unemployment following a strike or lock-out in which the claimant was "directly or indirectly" involved;
- most policies specifically excluded dismissal caused by the claimant's behaviour at work;
- sickness arising from alcohol and drug abuse was a standard exclusion along with self inflicted injuries and war and riot injuries;
- many of the policies excluded conditions for which "medical advice, treatment or consultation" had been received for periods of up to 3 years prior to the policy being taken out;
- all the policies had open ended exclusions relating to pregnancy and childbirth;
- four of the policies had exclusions relating to stress;

- three policies sought to exclude backache;
- most had specific clauses excluding HIV and AIDS sufferers;
- two policies excluded anything to do with radioactivity;
- mortgage insurance is not available to cover instances of relationship breakdown.

Even people who ensure that they take out a policy which is suitable for their needs may find themselves caught by the interpretation of some of the wider clauses in their policies, this could leave some people in the position of being denied private and state assistance and, therefore, facing homelessness. The DoE's survey of lenders and borrowers found that few borrowers with mortgage protection plans had drawn on them; two thirds of the claims had been unsuccessful for reasons relating to qualifying periods, lack of knowledge, and the way in which the insurance companies had interpreted the policies.[38]

The DoE's research reached the following conclusions on the cover currently offered by mortgage protection policies and their future potential:[39]

> MPPs offered little protection to those who fell into arrears for a number of reasons: their low availability; the low level of claims made by borrowers with an MPP; the low success rate among borrowers who did try to claim, and the fact that even successful claims did not prevent arrears accruing or the home being possessed. But what is the maximum impact they might have in preventing mortgage arrears? Under current schemes borrowers in part-time employment under 16 hours a week as well as temporary workers are typically excluded from cover. It is largely borrowers in full-time employment who are eligible for cover and eligible to submit a claim if they loose their earned income. Applying these criteria to the samples of borrowers showed that 27 per cent of those in arrears and 29 per cent of households who had given possession would have been eligible for a MPP and had had a change in circumstance that might have led them to claim. This suggests that the potential for MPPs is rather greater than is the case at present, although the low success rate of claims would erode that potential substantially. As a consequence, fewer than one in ten of borrowers in arrears or in possession would succeed in claiming and in most cases they would not avoid falling into arrears because the terms of insurance offer inadequate cover.
>
> Mortgage protection plans, as currently designed and operated, do not seem to offer adequate protection against arrears. It is hard to see what would be gained by expanding them in their current form. Indeed, it could be argued that in many instances they take borrowers' resources that might otherwise be put towards mortgage payments, while offering little in return.

The National Association of Citizens Advice Bureaux (NACAB) published a report on 8 June 1995 which draws on evidence from over 300 CABx in England and Wales on the

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[38] *Mortgage arrears and possessions; perspectives from borrowers, lenders and the courts*, 1995, p.61

[39] Ibid p.62

experiences of their clients with regard to mortgage protection policies.[40] In addition to finding problems with the quality of the policies, owing to restrictive definitions and qualifying conditions, the NACAB report highlights problems with the selling practices of the bodies which issue these policies:[41]

> Problems with selling practices include CAB clients being given inadequate information about the policy, or finding that the information they give the seller about their own situation is ignored. This can result in inappropriate selling - individuals finding that they are excluded from cover and could never benefit from the policy. At present, most selling of payment protection insurance is covered only by the Code of Practice covering general insurance, and operated by the Association of British Insurers, the trade association for insurance companies. The sanctions for breaches of the Code are minimal, and the ABI has difficulty in acting as a regulator as well as a trade association.

NACAB recommends that the current income support for mortgage interest provisions should be retained as a safety net for homeowners. The report goes on to suggest that if the proposals go ahead, the following work should be undertaken prior to their implementation:[42]

- fundamental reform of mortgage payment protection policies and a further review of the Code of Practice for selling general insurance;

- a Government led initiative to ensure that the insurance industry draws up, in consultation with interested parties, a minimum standard, with agreed definitions of terms, which all mortgage payment protection policies should meet;

- the Government to ensure premiums will be affordable;

- agree a broader interpretation of the Council of Mortgage Lenders undertaking not to take possession proceedings while income support is meeting the full interest due.

The ABI issued a Press Release on 7 June 1995 summarising the Deputy Director General's speech to the IBC Financial Focus Conference which, it stated, largely answered criticisms contained in NACAB's report. On the issue of selling practices the Press Release states, "the ABI has recently prepared draft guidelines on the selling of mortgage payment protection insurance. These require the essential elements of the insurance cover to be spelt out to prospective policyholders." The key points of the Deputy Director General's speech, as summarised in the Press Release, are reproduced below:

- If borrowers take out mortgage protection insurance following Government changes in income support benefit for mortgage interest, mortgage arrears should not increase but could actually fall over time.

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[40] *Security at risk*

[41] Ibid, p.1

[42] Ibid, para 5.55

- More than two-thirds of people in danger of having their home repossessed do not currently qualify to have their mortgage payments met by the state.

- High quality insurance cover is available - insurance companies are also expanding their range of policies to meet the growing and changing needs of customers.

- The cost of insuring mortgage payments is likely to fall but, even at present, a years's cover is equivalent to about 0.5% of the interest rate.

- Some lenders are reporting 30% of new borrowers taking out mortgage protection insurance and this percentage could increase significantly over the next two years.

- Virtually anyone who is able to obtain a mortgage should be able to purchase insurance to go with it. This includes the special categories of mortgage holders such as the self employed, single parents and part-time workers.

- The competitive nature of the mortgage protection insurance market means that new products are likely to be developed quickly and existing products refined to meet the likely growth in demand for this type of insurance in the future.

In a recent Question Time exchange[43] the Prime Minister referred to an initiative developed by the Skipton Building Society in which it is proposing to offer free unemployment cover to new and existing borrowers, irrespective of the nature of their jobs, from 1 October 1995. In addition, from 1 August 1995 existing borrowers with the Skipton who already have full accident, sickness and unemployment cover will have their premiums reduced by 30% (to around £4.50 per £100 of mortgage payment plus insurance premium tax).[44]

To qualify for free redundancy cover under the Skipton scheme borrowers will have to be between the ages 18-65, not in receipt of state pension, not in arrears of three months or more, not currently in claim and currently in work. The cover will last for seven months after a two month deferment period. The cover will only cover the interest due on the mortgage payments. To qualify for full cover new and existing borrowers will have to be between the ages of 18-65, not in receipt of state pension, currently in work and not aware of impending unemployment. Their cover will meet their mortgage repayments and up to an additional 25%. The cover will last for up to 12 months, there will be a 60 day excess period.

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[43] HC Deb 8.6.95 c316-7

[44] Skipton Building Society Press Release "Skipton stands alone in accepting Government's challenge" 8.6.95

Whilst conceding that it has not been possible to devise a scheme which will cover all borrowers,[45] the Chief Executive and Director of the Skipton has stated that this is "the most comprehensive and affordable scheme on the market and takes account of the changing employment market by including many of the self-employed and contract workers".[46] The approximate cost to the society of offering the scheme is well over £2 million.

The development of this scheme, which has been negotiated with ITT London and Edinburgh, provides evidence that the insurance industry may be able and willing to produce new products for borrowers. However, one could argue that the success of these products will only be tested when claims are made as it is at this point that the various exclusion clauses and interpretation of the clauses will become clear.

[45] for example, it appears that the scheme will not provide sickness cover for all borrowers irrespective of their health histories

[46] Ibid

VI The housing market

Despite a period during which rates of interest fell to their lowest point for 30 years, confidence in the housing market in the last four years has remained fragile. The failure of activity in the market to respond significantly to reduced interest rates has been attributed, in the main, to continuing concern over job security, the constraining effect of negative equity[47] and fear of future upward movements in interest rates. Information on house price movements is given in the table below:

Table 2 Mix-adjusted house prices indices by region: All dwellings: 1990=100

The table shows movements in house prices according to the Department of the Environment's mix-adjusted house price index. The indices are based upon a 5 per cent sample of building society mortgages. It thereby excludes dwellings purchased without a mortgage or with a loan from another source. House prices in the UK have remained relatively stable but gradually fell following their peak in 1989 and although there was a small increase between 1993 and 1994, prices are still around 7 per cent below their 1989 level. However, this national picture masks differences between the regions. In the North, Yorkshire and Humberside, North West, Wales, Scotland and Northern Ireland, prices are above their 1989 level, while in the South East prices are 20% lower than in 1989.

Period	Northern	Yorks & Humber	East Midlands	East Anglia	Greater London	South East (excl GL)	South West	West Midlands	North West	Wales	Scotland	Northern Ireland	UK
1980	33	33	33	35	32	34	36	35	36	35	42	63	35
1981	41	37	36	36	33	35	37	36	38	38	46	62	37
1982	43	37	37	38	34	36	38	37	39	40	50	64	38
1983	47	42	41	41	37	40	42	40	43	44	56	69	42
1984	50	45	45	45	44	46	46	43	45	46	59	72	46
1985	52	47	48	51	50	51	50	45	47	50	62	77	50
1986	57	52	53	59	62	60	58	49	52	54	66	81	57
1987	61	56	60	71	76	73	68	56	55	59	70	87	67
1988	68	66	77	96	94	94	91	75	65	71	76	90	84
1989	88	92	100	112	102	109	110	98	87	96	90	95	101
1990	100	100	100	100	100	100	100	100	100	100	100	100	100
1991	101	104	98	97	96	95	97	100	101	99	108	107	99
1992	105	102	96	92	86	88	91	97	103	98	113	109	95
1993	107	103	93	88	85	84	88	96	99	99	117	114	93
1994	110	100	94	88	89	87	89	96	101	99	118	118	94
1992 Q1	100	103	97	89	94	91	95	100	104	103	112	104	97
Q2	106	105	96	91	86	87	91	99	102	97	112	108	95
Q3	105	104	96	93	86	88	92	97	103	97	115	110	95
Q4	111	95	92	89	81	84	87	94	101	94	115	114	92
1993 Q1	102	106	91	87	86	83	84	95	99	96	113	111	92
Q2	105	98	92	86	85	84	84	92	98	101	119	112	92
Q3	111	106	94	90	87	86	90	98	98	96	119	121	94
Q4	109	102	93	87	82	84	90	93	99	99	115	114	92
1994 Q1	109	102	92	87	84	86	86	99	101	96	114	118	93
Q2	108	100	93	89	91	86	90	97	98	100	117	109	94
Q3	112	99	95	88	90	87	89	96	101	105	122	124	95
Q4	112	100	93	88	88	87	90	95	103	94	117	121	94

Notes: (a) The small sample size means that quarter-to-quarter changes should be interpreted with caution.
(b) The DoE mix-adjusted house price index is based upon a 5% sample of building society mortgage completions and thereby excludes dwellings purchased without a mortgage or with a loan from another source. The mix of dwellings purchased changes over time and a house price series that takes account of this provides a better measure of true house price movements than an index based on the simple average price.

Sources: *Department of the Environment mix-adjusted house price index, various editions*

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[47] an estimated 677,440 households in the UK were affected by negative equity in the fourth quarter of 1994 according to DoE house price data [HC Deb 15.3.95 c.592W]

Housing commentators believe that the proposed cuts in ISMI will act as a further depressant on the housing market. The reasons given for this are summarised below:

- the cost of house purchase will be required to take out a private insurance policy to cover their payments in the event of unemployment, sickness etc;[48]

- many potential buyers will find it difficult to obtain private insurance, eg those who are self employed or on fixed term contracts, and will find themselves unable or unwilling to enter the market;

- the cuts in comprehensive state assistance will result in increased repossessions which will, in turn, depress house prices and prolong the time in which households remain in the negative equity trap.

It has also been predicted that, as insurance companies develop differentiated products and premium rates based on factors such as the policy holder's age, sex, occupation and post code, and as mortgage lenders become more inclined to "cherry pick" the best clients by offering discounted loans, the housing market will become characterised by a "two-tier" effect. The divides in the market which already exist in terms of property location and type are expected to worsen, with the result that poorer buyers will find it harder, and more expensive, to get on the housing ladder.[49]

In addition to the proposed cuts in ISMI, mortgage interest relief (MIR) was reduced to 15 per cent from April 1995 from its previous level of 20 per cent. It is estimated that the cost of mortgage insurance together with the reduction in MIR will result in a 10 per cent per annum increase in the mortgage costs of a typical borrower by the end of 1995 (assuming no further rises in interest rates).[50] The CML has questioned the timing of the Government's proposals given the already depressed state of the market and the fact that interest rates are now rising again.[51]

Research by UBS Limited into the possible effect of the complete removal of state support for mortgage interest payments, combined with incomplete private insurance coverage, concluded that house prices would fall by 7 per cent and repossessions would initially rise by 13,000 per year. It is estimated that a 7 per cent reduction in prices would wipe £4,500

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[48] the current average cost of mortgage protection insurance policies is around £7 per £100 of mortgage payment per month up to a general maximum of £1000 per month [HC Deb 9.12.94 c.390-1W]

[49] *Roof Briefing*, February 1995

[50] *Inside Housing* 9.12.94 "New buyers to be left home alone"

[51] CML Press Notice 7.3.95 "Income support - CML continues to campaign for rethink"

off the value of the average home and nearly £70 billion off personal sector housing wealth.[52] The complete removal of state support is not being proposed; however, a similar, if less severe, effect on the market is being widely predicted.

The housing market affects the wider economy in several ways; empirical studies have shown that changes in the market value of housing wealth have a strong impact on consumers' expenditure. A study by Peter Westway of the National Institute of Economic and Social Research found that mortgage equity withdrawal in 1988 represented over 7 per cent of personal disposable income; this exceeded the amount of consumer borrowing which was lent explicitly for consumption purposes and boosted overall consumer spending by 2.5 per cent at the peak of the boom. By 1992 this flow of funds had all but disappeared with the result that the slump in consumption was exaggerated by over 1.5 per cent.[53]

The housing market also interacts with the wider economy to affect wage settlements, regional migration decisions and its overall rate of growth. Reduced rates of interest and falling house prices have failed to produce any sustained increase in demand in the housing market which, in turn, has inhibited the development of a construction led recovery. Cuts in investment in the development of new social rented housing have meant that this sector has been unable to provide the necessary impetus for growth in the construction industry. Furthermore, several respondents to the proposals have noted that Government policies aimed at creating a "flexible" labour market by encouraging part-time, self employed and contractual work will come into conflict with the aim of increasing home ownership as these groups will be excluded, or will find it difficult to obtain mortgage insurance or benefit.[54]

Therefore, there is concern amongst housing commentators that the curtailment of ISMI, in the absence of any other measures to assist the market and prevent an increase in repossessions, will do nothing to aid recovery and may actually be damaging.

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[52] UBS Limited 17.11.94 "An end to income support for mortgage interest payments - what implications for the housing market?"

[53] National Institute of Economic and Social Research, *Mortgage Equity Withdrawal: Causes and Consequences,* Discussion Paper No 59, 1994

[54] TUC *Mortgage Payers at Risk,* 9.2.95

VI Home ownership and Government policy

A major plank of Government housing policy since 1979 has been the growth of home ownership. This commitment has been consistently reaffirmed:[55]

> **Home Ownership**
>
> **Mr. Nicholas Winterton**: To ask the Prime Minister if it remains the policy of Her Majesty's Government to promote home ownership; and if he will make a statement.
>
> **The Prime Minister** *[holding answer 20 January 1995]:* Yes. Owner-occupation in the United Kingdom has risen from just over 54 per cent. in 1979 to over 66 per cent. now. Home ownership is more affordable than for many years. Surveys show that owner-occupation is the preferred housing choice of about 80 per cent. of people. The Government remain fully committed to promoting the continued growth of sustainable home ownership, both by prudent management of the economy and through specific policies to help people become home owners.

Measures which have been introduced to promote the growth of home ownership include the Right to Buy and Mortgage to Rent schemes, cash incentive schemes (also know as tenants' incentive schemes), which enable public landlords to give cash lump sums to certain tenants to help them buy in the private sector, and the development of low-cost home ownership schemes such as shared ownership. The announcement of the Housing Corporation's 1995/96 Approved Development Programme (ADP) in December 1994[56] confirmed a trend away from the development of housing for rent by housing associations towards incentive grants and the development of housing for sale on shared ownership terms. The tenants' incentive scheme programme for 1995/96 is the largest to date and the Do It Yourself Shared Ownership (DIYSO) programme has also been protected from the brunt of the £297 million cut to the total ADP. Associations are expected to achieve most of their sales under DIYSO to council and housing association tenants.

Those housing associations which are involved in low-cost home ownership initiatives have suggested that the proposed cuts in ISMI will hit their client group hard as building societies will be reluctant to lend to people on the margins and who are more likely to lose their jobs.[57] A 1993 study into shared ownership which involved, *inter alia*, interviews with over 1,250 shared ownership households, found that shared owners were under represented in the professional and skilled manual occupations and over represented in the intermediate and junior non-manual occupations compared with other first time buyers.[58] In terms of income,

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[55] HC Deb 23.1.95 c.25W

[56] HC Deb 15.12.94 c.735W

[57] *Housing Association Weekly* 16.12.94 "Budget setback for low-cost home owners"

[58] DoE *An Appraisal of Shared Ownership,* 1993, para 5.10

the study found shared owners to have a lower average weekly net household income (£240) than all first time buyers.[59]

It has been suggested that there is a certain irony in the Government's promotion of policies which encourage people in the social rented sector to buy their own homes as these people are least likely to have substantial personal savings, and are most likely to find immediate difficulty in meeting their mortgage repayments in the event of unemployment or illness.[60] If eligibility for ISMI is reduced it is felt that demand for and the viability of the Government's low- cost home ownership initiatives will be threatened:

> Lenders will be more reluctant to support these initiatives if there is no state support to assist people to cope with difficult, but temporary, adverse changes in their circumstances. All the evidence now suggests that the labour market is changing and that more and more households will face temporary unemployment, therefore the prospect of this arising becomes ever greater.[61]

The Government has rejected the proposition that proposals contained in the 1994 Budget will act as a disincentive to home ownership:[62]

> **Mr. Nicholas Winterton**: To ask the Chancellor of the Exchequer if he will identify those proposals in his latest unified budget which are intended specifically to promote home ownership.
>
> **The Minister of State, Treasury (Mr. Anthony Nelson)**: My right hon. and learned Friend's most recent Budget included measures to double grants to help council tenants buy homes and Housing Corporation programmes, worth £208 million, to extend home ownership.
>
> **Mr. Winterton**: I am grateful to my hon. Friend for that response and I recognise the basic strength of our economy, but does he accept, however, that for many decades it has been Conservative party policy to encourage home ownership? Does he accept that recent Budgets have provided a disincentive to home ownership and that the housebuilding sector of our economy is critical to our economic success, as so many other sectors of manufacturing depend on it? Does he also accept - I say this with some regret - that the latest interest rate rise is thoroughly undesirable and will thoroughly depress the building sector?

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[59] Ibid, para 5.12

[60] *Housing Finance No 24*, November 1994 "Income Support for Mortgage Interest: Trends and Issues"

[61] Ibid

[62] HC Deb 2.2.95 c.1206

Mr. Nelson: Let me assure my hon. Friend that the Government remain firmly committed to home ownership, which, since we took office, has increased by 4.3 million to 15.6 million. On the interest rate increase, there can be no doubt that the health and prospects of the housing and construction markets rely on a period of sustained low inflationary growth. It is my right hon. and learned Friend's judgment that that is most likely to be achieved if we continue to bear down on inflation. We have no interest in setting interest rates higher than is necessary to achieve that objective.

Please cut

Research Paper 95/73 **Section Code: ESSS**

Title: Income Support and help with mortgages

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