

# Developing safety nets for home-owners

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**Solutions**  
**Lessons for policy**  
**and practice**

## What's the issue?

Home-owners are currently poorly protected against loss of income – take-up of private insurance is low and the state safety net has been cut back.

## What are the problems?

- Fewer than one in five of the 12 million households who have mortgages have private insurance, a much lower uptake than the government had hoped for.
- The state safety net has been restricted since 1995, and most home-owners now have to wait nine months before they get help.
- Mortgage possessions are forecast to reach 45,000 in 2008 – the highest number since the mid-1990s.
- Modelling suggests that if the last housing recession were repeated today serious arrears would be 25 per cent higher now than they were then.

## Ways forward

- The safety net would be strengthened considerably by introducing a Sustainable Home-Ownership Partnership (SHOP) scheme, which 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.
- After two months of lender forbearance SHOP would make non means tested payments to meet full mortgage capital and interest payments for ten months in response to the 'designated' risks of unemployment, the failure of self-employment, accident or sickness. Payments could continue after then, but on a means tested basis. Means tested payments would also be available to households who had suffered a loss of income, but did not qualify under one of the designated risks.
- A Housing Tax Credit would complement SHOP by providing assistance to home-owners in low paid work. This would both support home-owners who face a sharp drop in income without becoming wholly unemployed, and also make it easier for home-owners to move off SHOP into low-paid employment without facing a net reduction in their incomes.
- As a first step a Housing Tax Credit could be targeted on the highest housing cost regions where the current Child and Working Tax Credit scheme is less effective in ensuring that home-owners are better off returning to work, the unemployment trap is most prevalent and severe. A longer-term solution would require an overhaul of the tax credit and Housing Benefit schemes to create a single integrated system.

## Author

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# The case for change

Almost seven in ten households are home-owners and 12 million households have mortgages. The government is committed to the continued expansion of sustainable home-ownership. Mortgage arrears and possessions fell to very low levels in the early 2000s, helped by the benign climate of the lowest interest rates for 40 years, unemployment at its lowest level for 30 years and rising house prices.

The evidence shows:

- The economic climate is changing. Mortgage rates rose from 5.49 per cent in March 2003 to 7.44 per cent in July 2007. Despite recent cuts in base rates, there is clear evidence of a downturn in the housing market.
- House repossessions arising from mortgage default have been rising for several years and the Council of Mortgage Lenders expects this trend to continue and for repossessions to reach 45,000 in 2008 – the highest level since the mid-1990s.
- During the last housing market recession the existing safety nets for home-owners were shown to be inadequate and some 300,000 households lost their homes in just five years. Since then the state safety net, Income Support for Mortgage Interest (ISMI), has been cut back so that most home-owners have to wait nine months before they get help.
- The government hoped that half of all home-owners with mortgages would take up private insurance, but this never happened and take-up has now fallen so that fewer than one in five households now have private mortgage payment protection insurance.
- The shift to a low inflation economy also means that the burden of payments that characterise the early years of home-ownership now persist for longer as earnings increase less quickly, so extending the period of high risk. Modelling suggests that if the last housing recession was repeated today serious arrears would be 25 per cent higher now than they were then.

# Possible ways forward

In response to the inadequacies of the existing safety net for home-owners, the Joseph Rowntree Foundation established an inquiry to investigate how safety nets could be improved. The Inquiry concluded that neither the status quo nor the incremental improvement of existing mechanisms would provide acceptable levels of protection for home-owners.<sup>1</sup> It recommended that two possible ways of strengthening the safety net should be examined in more detail. These were the Sustainable Home-Ownership Partnership (SHOP) and Housing Tax Credits.

## The Sustainable Home-Ownership Partnership (SHOP)

SHOP would be a levy system designed to provide pooled funding that could be accessed by borrowers in order to manage clearly delineated circumstances that have the potential to lead to mortgage arrears and possessions. It is intended to assist home-owners with mortgages, including shared owners, but not owners of second homes or private landlords. It would involve the rolling up of ISMI and private insurance into a single scheme to which lenders, government and borrowers would contribute.

SHOP would provide the following protection:

- **Non-means tested payment of actual mortgage capital and interest payments** from the beginning of the third until the end of the twelfth month following the occurrence of a particular 'designated' risk, such as unemployment, failure of self-employment, accident or sickness, and means tested assistance thereafter if the unemployment, sickness, etc. continues.
- **Means tested assistance with mortgage capital and interest payments** from the third month, and indefinitely if the loss of income arises from a non-designated risk.
- **During the first two months, lenders would be expected to exercise forbearance.**

### Institutional structure

The project team assessed four organisational types and concluded that the most suitable organisational structure for SHOP would be a joint venture between lenders and the government, each of which would nominate members of the board. This structure would ensure transparency and accountability to the partners and would minimise the impact on public spending, as only the government contribution would score.

If it proved to be impractical to establish a joint venture, SHOP could also be run as a non-departmental public body (NDPB) with the board appointed by the government (although other interests could still be represented). Unlike the joint venture, borrowing by a NDPB would score as public spending.

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<sup>1</sup> A summary of the findings and conclusions of the 2004 Joseph Rowntree Foundation Inquiry, 'Home-ownership risks and sustainability in the medium term' by Steve Wilcox, is available as a free pdf on the JRF website ([www.jrf.org.uk](http://www.jrf.org.uk)).

### **Should SHOP be compulsory?**

The project team concluded that SHOP should be compulsory for all new borrowers, and borrowers who remortgage. While initial coverage would be limited this would grow very quickly since new mortgages represent some 10 per cent of all mortgages.

The principal reason for recommending compulsion is to ensure that it brings protection to substantially more households than would be the case if it were voluntary. Although many focus group participants believed that it was wrong in principle to make SHOP compulsory, these objections were much diminished when the cost of SHOP was revealed.

The team found that the case for compulsion was strengthened considerably when legal considerations were taken into account. To be consistent with competition law a voluntary scheme would either have to market products that the market does not provide or extend such products to individuals who are not covered by the market. Such a scheme would be unlikely to extend the reach of the current safety net very far. However, the team found that a compulsory scheme could be justified by the 'solidarity' principle that underpins compulsory state social security systems.

### **What risks would be covered by SHOP?**

Non-means tested assistance under SHOP would be available in response to four clearly delineated risks: unemployment, accidents, sickness and failure of self-employment. The project team considered the possibility of including the coverage of SHOP to cover risks that the private market will not insure against, notably relationship breakdown. The team concluded that it would be impractical to include protection against relationship breakdown due to the inevitable difficulties in verifying claims. This view was supported by focus groups. However, means tested assistance would be available in response to loss of income for any reason and this might arise from relationship breakdown.

### **Does lender forbearance need to be enforced?**

In response to concerns expressed by participants in focus groups as well as the Citizens Advice Bureau the project team examined whether lender forbearance would need to be enforced. The team concluded that it would be necessary either to establish a pre-court protocol or for rules to be written into the SHOP scheme as current regulation does not monitor cases individually.

### **How much would SHOP cost?**

The team has examined the costs of private insurance and ISMI and has assessed the rate of contribution for SHOP to be £3.40 per £100 of mortgage payments covered. This would be shared between the partners, with borrowers paying £1.70 and lenders and government each paying 85 pence per £100 of mortgage payments. The lenders' contributions would be adjusted over time to reflect the level of claims on their book. This represents very considerable savings compared with private insurance. It is envisaged that the fund would accumulate sufficient funds to smooth payments over the economic cycle. However, if it were implemented during a recession it may be necessary for pump-priming funds to be provided, or for the fund to borrow money.

### **How would SHOP's finances be structured?**

In the original proposal for SHOP it was envisaged that the body administering SHOP would also administer the whole fund. The project team also explored the option of using block insurance from the private sector for the non-means tested component of the scheme. This would have the clear advantage of spreading risks and utilising existing administrative capacity and expertise.

## Housing Tax Credits

While SHOP would provide an improved safety net this would be mostly for out of work home-owners who suffered a total loss of income.

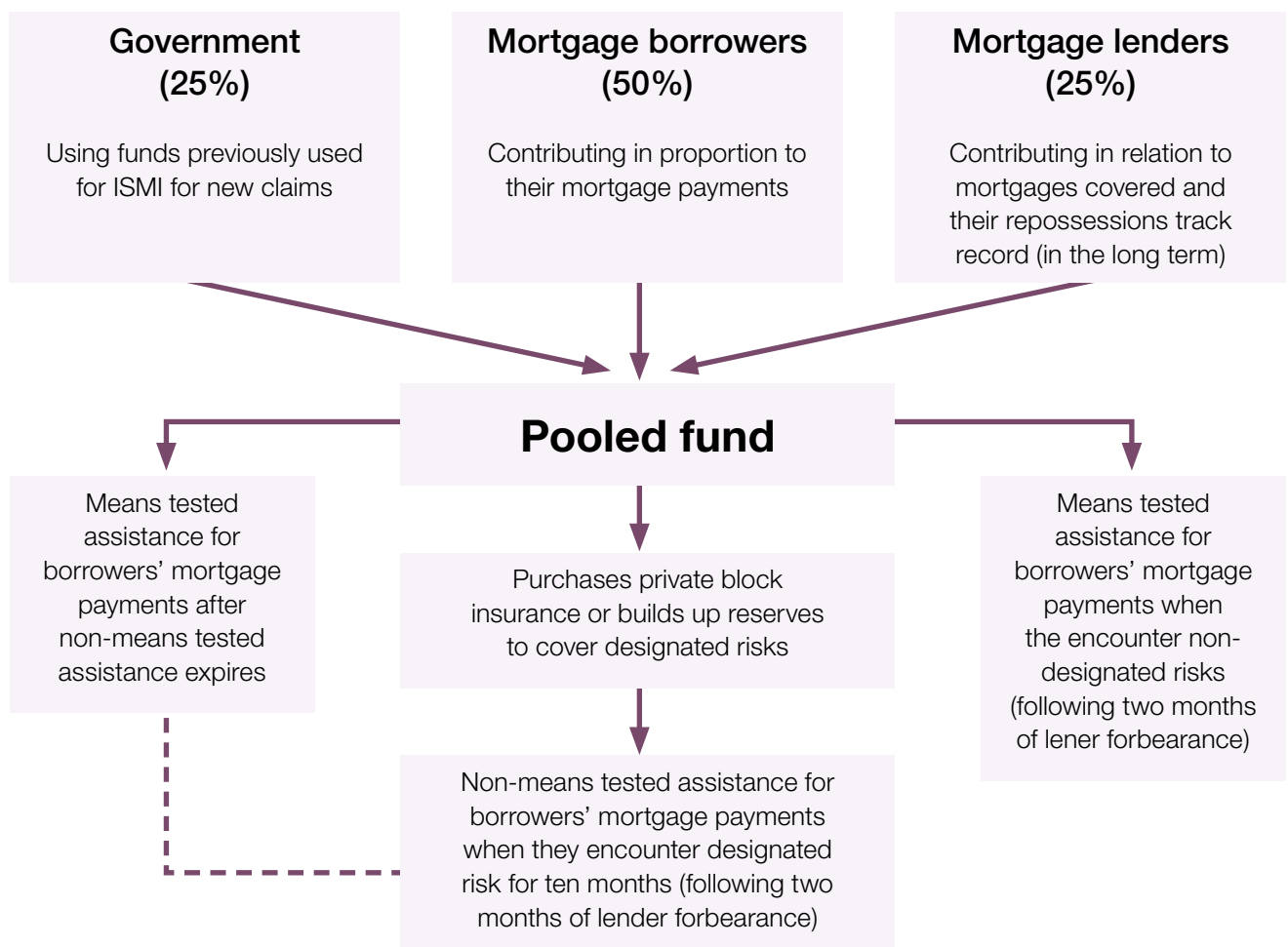
At present, where home-owners live on low incomes there can be a significant unemployment trap – the loss of social security benefits outweighs the gains in income when households who are out of work take employment, or the gains are so small that there is very little financial incentive to take work. Unlike tenants, who can claim Housing Benefit when in work, home-owners are not entitled to assistance when they are in low-paid employment. This would remain the case if ISMI were to be replaced by SHOP.

One way to assist low-income home-owners would be to extend Housing Benefit to home-owners. However, there is evidence that only a half of eligible working tenants claim Housing Benefit, and that working home-owners are less likely than working tenants to claim tax credits. The take-up rate of tax credits by working families has significantly improved under the Child and Working Tax Credit regime introduced in 2003/04.

The present tax credit system is reasonably effective in ensuring that low-paid home-owners with modest mortgages are better off in low-paid work, but in high-cost areas it is much less likely to provide sufficient support to achieve that objective. This results in a potential unemployment trap for home-owners considering moving into low-paid work, and a high incidence of poverty among the low-income home-owners that are in any event engaged in low-paid work.

While a general increase in tax credits would remove more home-owners from the actual or potential consequences of the unemployment trap, this would be expensive and not especially well targeted. For this reason a Housing Tax Credit could be introduced in the regions where, due to high house prices, the unemployment trap is most prevalent. This has precedent: the In Work Credit, which is intended to encourage lone parents to take employment, is currently being piloted with a higher rate being available in London principally to reflect the capital's higher housing costs.

**Figure 1: The design of SHOP**



A Housing Tax Credit structured as a regional addition to the current structure of tax credits in high cost regions would be a useful and practical first step, and would have very limited direct costs. A £20 Housing Tax Credit for London, for example, would cost £210 million a year. In supporting home-owners' moves back into low-paid employment, however, it would also assist in limiting the costs of SHOP.

In the longer term there is a case for a more radical reform of the Housing Benefit and Tax Credit systems with a view to creating a single integrated system to assist households in low-paid work that takes into account both their housing costs and the expense of raising children.

## About the project

The project was conducted by Mark Stephens, Steve Wilcox and Mark Bevan at the Centre for Housing Policy, University of York, and Mike Dailly at the Govan Law Centre, Glasgow. The work for this project was based on the examination of existing data, including relevant legal cases. This was supplemented by eight focus groups with home-owners that were conducted in York, Doncaster and Leeds in 2007.

## For further information

The full report, **Developing safety nets for home-owners** by Mark Stephens, Mike Dailly and Steve Wilcox, is published by the Joseph Rowntree Foundation. It is available as a free download from [www.jrf.org.uk](http://www.jrf.org.uk).