Challenges for our Home Ownership Safety Net: UK and International Perspectives

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Acknowledgements and contacts

This research was undertaken for UK Finance by Peter Williams, Steve Wilcox and Christine Whitehead.

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Executive Summary

- This report is based on a rapid review of how the safety net for mortgage borrowers in the UK has evolved over recent decades and compares this with experience in other countries.
- For the UK, it is now evident that by 2022 there will only be limited government financial support for home buyers in distress, and that will mainly be in the form of loans for those not in work. The 'work allowances' for home buyers under the Universal Credit scheme will provide much more limited support to home buyers in part time and low paid work than available under the current tax credit and welfare schemes. The 'system' will be reliant upon individuals and their actions as well as on lender forbearance within the legal and regulatory safeguards that have been built into the operation of the mortgage market.
- Given where the UK is in the interest rate cycle and considering the tensions that exist within the housing market around affordability and the uncertainties surrounding Brexit, the question then is whether this is enough?
- Recognising the relatively open nature of the UK mortgage market and the continued volatility of our housing market, this report suggests it would be timely for government to review the home owner safety net situation systematically and comprehensively.
- A safety net for individual home buyers in the UK was mainly put in place during the deep recession of the early 1990s when large numbers of mortgage borrowers lost their homes.
- In response to global financial crisis of 2008, the government strengthened the safety net with a number of measures. Most of the funded measures have now been withdrawn (though remnants exist in the devolved nations) and this stepping back continues with the switch from Support for Mortgage Interest (SMI) as a grant to a repayable Loan for Mortgage Interest (LMI) in 2018. To date the impact of reducing the scope of the safety net has been muted. Arrears and possessions numbers remain low.
- Conduct and prudential regulation introduced after the financial crisis means that the current mortgage market is better insulated from systemic risks than it was previously. This reflects the contraction in lending to those deemed to be higher risk borrowers, the reduced number of interest only and high LTV loans and the imposition of stress tests that limit the scale of household exposure.
- At the same time the 'protection' offered by much reduced interest rates since 2008 may now be under threat, and the more rigorous rules for entry to the sector cannot remove inherent risks to mortgage borrowers resulting from unforeseen changes in individual circumstances.
- The comparison of safety nets in other countries suggests that many countries do not have mortgage-specific safety nets, in some cases this is because they have more generous income support measures already in place. While some countries - like the UK in the early 1990s - introduced regulations and conditions to protect those in mortgage distress after earlier crises, in the main these were not put to the test as a result of the global financial crisis, mainly because of interest rate reductions.
- In countries where mortgage markets have suffered particularly badly as a result of the global financial crisis and subsequent recessions, governments have often responded with emergency policies e.g. to reduce evictions, modify mortgage terms, transfer dwellings into the rental sector, and sometimes give additional direct support to owner-occupier households in financial stress.

- For the most part, however owner-occupiers who are unable to negotiate a means of catching up with their payments are expected to sell and what government assistance they continue to receive is within the rental market.
- In almost all countries there has been increased regulation to support macro-stabilisation policies and limit the risks taken by financial institutions. These tend to restrict access to owner-occupation and potentially reduce the need for mortgage safety nets in future downturns.

Introduction

The concept and language of a safety net for home owners and the housing market are relatively recent ones - at least in explicit terms.

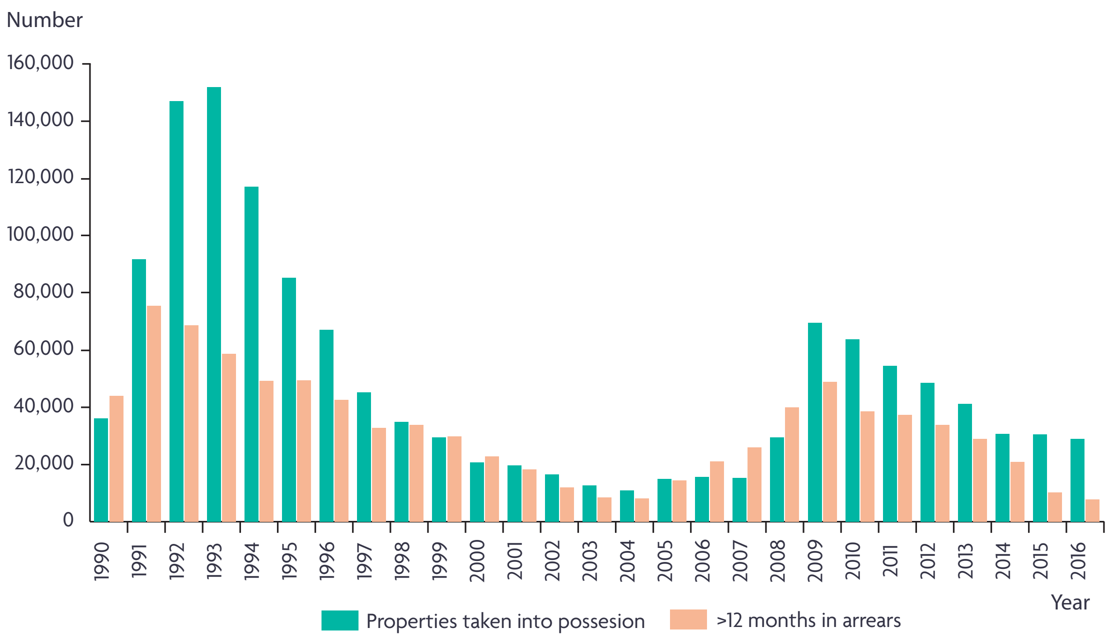
In the 1960s to the 1980s we saw an expansion of both home ownership and the mortgage market, with the consequence it drew in an ever wider spectrum of households. Unsurprisingly during this period the focus of debates was very much about access to home ownership, interspersed with arguments about red-lining and exclusion and the impact of urban regeneration. The focus was on expansion rather than disruption and its potential negative impacts on households, markets and the economy.

It was the sharp rise in the number of households in arrears or facing possession in 1990 that prompted the Major Government in 1991 to intervene in a sustained way in the housing market and begin to put in place a more multi-faceted 'safety net' to protect home owners from the market downturn. It should be stressed at the outset that there has never been an articulated plan nor a formal safety net but rather a series of measures that together make up a structure that approximates to a safety net of sorts, with much turning on how wide or narrow this might be defined.

This report provides an opportunity to reflect on this so called safety net, how it has developed over time and to consider whether it is fit for purpose in both current and likely future contexts. We do this through careful examination of the situation in the UK, but also informed by exploring similar structures in a selection of countries.

The downturn of the early 1990s marked the last time the UK had a largely 'unmodified' housing market recession with 75,500 possession cases in 1991 (see Figure 1). As John Kay has argued, this was a time when we had 'a perfect storm of falling prices, high interest rates, inflation and recession hit UK housing'[1]. The government brought in measures in 1992 to manage this situation and these have been replicated in one form or another in subsequent market downturns. The question is will that position be maintained?

Figure 1: Mortgage arrears and possessions continue to fall, UK



Source: UK Finance
Notes: Includes small numbers of BTL cases for the years before 2014 for 12+ months in arrears and before 2007 for possessions.

[1] Kay, J (2010) *Bankers can't blame the UK housing market*, Financial Times, column.

What is striking now is how much more oversight and management of the UK's housing and mortgage markets there is compared to previous periods. We saw major interventions in the 1950s and 1960s, in terms of funding for new public housing (and, for example, the provision of local authority mortgages) and interventions in the 1970s such as the Joint Advisory Committee (JAC) between the Government and the Building Societies Association through which there were efforts to control house prices via the flow of mortgages. But since 2000 a vast panoply of measures have come into place all of which impact upon risk in the housing and mortgage markets.

Some measures had different and wider intent than supporting home owners in difficulty. Indeed what is clear is that, prior to 1990, such risks were seen as being borne mainly by individuals (and by extension not the focus of government) whereas post 1990 it was recognised there were risks to financial and economic stability as well as huge political pressure to intervene. Lenders rightly have been focussed upon the risks to borrowers and this remains the central continuing concern (see BSA, 2011a and b). Berry and Williams (2011, page 21 on) discuss some of the principles underlying safety net provision arguing that short-term support from government to owners is both efficient and justified in equity terms. They also take the view that the safety net as a whole is a shared responsibility across borrowers, lenders and government.

The measures are all part of the context we are reviewing and, in passing, we note not all have worked fully in favour of home ownership. For example, the measures brought in during 2009 to underpin the housing market actually helped ensure that house prices remained higher than might have been the case had a full market collapse followed – as was more obviously the case in the USA, Spain and Ireland. However, the protracted period of ultra-low interest rates has meant that households are exposed to housing-related price risks for a substantially longer period than in the past. This has recently prompted David Miles to reiterate his arguments for mortgages in which this risk is shared with mortgage lenders and indeed government (Miles, 2017).

Safety nets – definitions and instruments

As we mention above, there are different ways of viewing the concept of safety nets. The narrowest definition of a mortgage safety net is one that covers only the provision of support to individual households who find themselves in difficulties in paying the mortgage as a result of changes in their individual circumstances, notably as a result of sickness, unemployment or loss of earnings. In other words the safety net addresses the outcomes of unpredictable (or unpredicted) events for individuals. A more inclusive definition would include not just reductions in income but also increases in mortgage outgoings, notably as a result of increases in interest rates.

In practice what we observe is a mixture of different approaches some of which anticipate the possibility of problems; others of which respond to their emergence.

In this context we can identify three distinct types of instrument which can be used separately or together to produce different forms and levels of safety net.

1. The provision of insurance products that enable individuals to cope with adverse changes in circumstance - nearly always covering only loss of income;
2. General welfare support which helps maintain the household income required to meet basic outgoings;
3. Housing specific support which takes account of the individual's actual housing costs - notably with respect to mortgage payments and rents - as well as their income and family circumstances.

Widening the definition further, there is a fourth and increasingly important approach which involves putting in place regulatory and other measures that help ensure that some individual households avoid facing a crisis.

In the context of the mortgage market this normally implies excluding households who are seen as being at too high a risk of not meeting their mortgage payments either because of increases in those costs, notably as a result of interest rate changes or because of reductions in income.

We have taken this wider view of safety nets and related instruments in this report, not least so we can properly reflect on what safeguards are in place for households, lenders, the housing market and the wider economy. In categorising these instruments we have also taken account of the drivers of safety net policy; the rationale for putting specific approaches in place; and who is responsible for their operation.

In summary therefore this review includes:

1. Approaches that directly address changes in individual circumstances, notably loss of income through unemployment; sickness, accident etc. and also sometimes increases in cost. These can be put in place by government to ensure an adequate standard of living; by the industry as a cost effective way to support those with problems; or by the wider market through insurance. In practice these measures tend to address changes in income more often than changes in housing specific costs.

2. Measures that are put in place by government and/or the industry usually in response to systemic problems in the mortgage market - such as around 1989/90 and after the global financial crisis. These help individuals even though they may be aimed more directly at stabilising the mortgage market. They tend mainly to support those who fall into arrears or are at risk of eviction.

3. Longer term regulatory changes often related to macro-prudential stabilisation policies which aim to ensure that those who buy can maintain their mortgages when circumstances change. These help to de-risk the mortgage and wider finance markets. However they often do so at the cost of excluding households who have the potential to pay, notably because they are based on ‘average’ assessments and evaluating circumstances at the point when the mortgage is granted. The impact of these constraints may, in some circumstances, be offset by other policies such as mortgage guarantees and insurance which reduce the costs to institutions of taking on higher risk households.

Looking Backwards

It is sensible to offer a brief backwards look at how the safety net in the UK has evolved through government schemes and interventions plus industry initiatives. In summary;

1970-1999

As higher LTV lending became more commonplace in the 1970s reflecting the growing demand for home ownership, most lenders backed the risks of such lending with a mortgage insurance indemnity guarantee (MIG) or the creation of their own fund. The MIG policy was paid for by the borrower but was in favour of the lender.

Consequent upon the housing market downturn in the period 1989 to 1991 mortgage possessions rose rapidly from around 15,000 in 1989 to 45,000 in 1990 and over 70,000 in 1991. The downturn triggered a major call on these MIG policies which in turn revealed severe problems with the arrangements in place.[2]

Government moved to allow the existing Income Support for Mortgage Interest (ISMI) payments to out-of-work home buyers to be paid direct to lenders in exchange for them developing forbearance and mortgage to rent schemes to help keep households in their homes.

This began a partnership between government and lenders around a home ownership safety net, which was then tested by the 1995 changes to ISMI, when government began to require a nine-month waiting period before payments could be received and at a standard rate of interest, effectively saying to the industry that lenders had clear 'ownership' of those first nine months and should respond to difficulties by offering rescheduling of the loan and other mechanisms. As part of the same announcement, the government also argued that home buyers should all take out mortgage payment protection insurance (MPPI) to cover the risks of being unemployed or being out of work through ill health or an accident (see Kemp and Pryce (2002) for a useful overview).

In 1997 agreement was reached with the government to create a Sustainable Home Ownership initiative with the aim of increasing MPPI take-up to 50 per cent of all borrowers (a figure arrived at through research related to those who could, or could not, sustain payments for a year - the period covered by MPPI; Whitehead and Holmans, 1999). A partnership steering group comprising lenders, insurers, government departments, the Bank of England and consumer groups was set up to oversee the initiative.

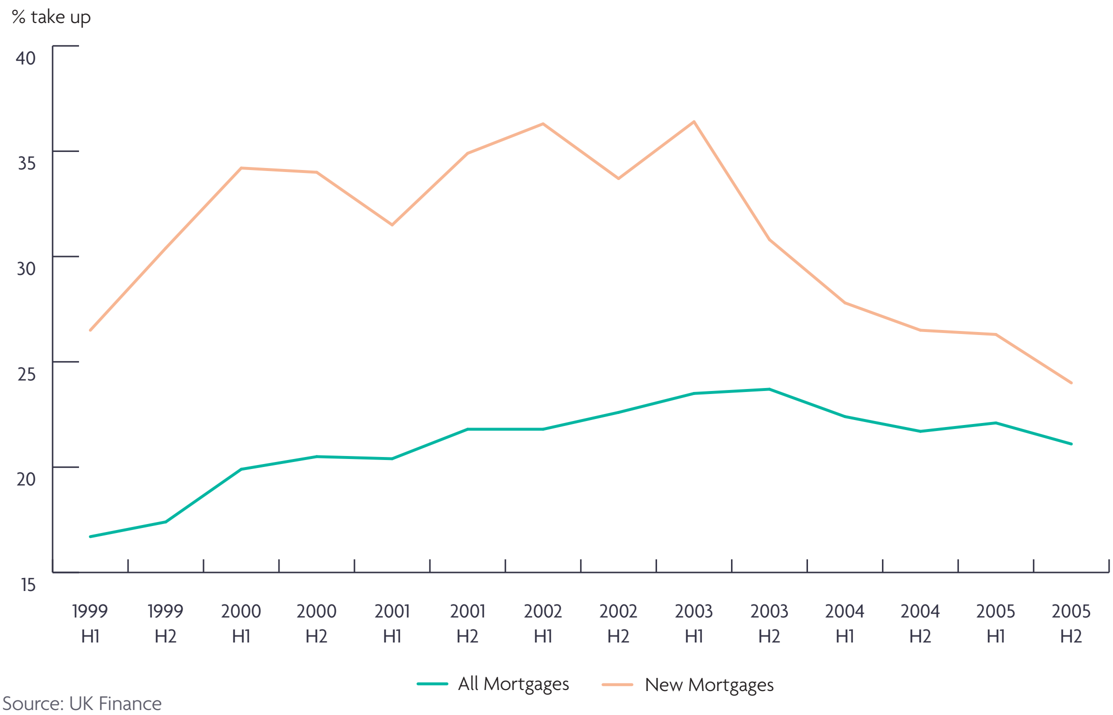
The 2000s

In practice, with a growing economy and rising employment (and a product which had significant flaws[3]) it proved difficult to increase take-up to the level desired. It peaked at a little under 25 per cent of all mortgages in 2003, although the proportion of new first-time buyers with insurance did rise at one point to 46 per cent (with 36 per cent of all new mortgages covered by insurance, see Figure 2). MPPI policies were rewritten as part of an agreed framework that set a benchmark for the industry and effort was made both to increase sales and improve the payment performance of the product. Some lenders offered MPPI free with their mortgages (see Ford et al., 2004).

[2] The sharp rise in MIG claims resulted in insurers facing claims of around £1.65 billion in 1991 and £1.25 billion in 1992 (although some 10 per cent of the market was probably self-insured). With annual premiums totalling around £235 million, possessions were a serious cost to the insurers estimated at around £4 billion for this period, with lenders arguing they lost similar amounts (UBS Phillips and Drew, 1991). Insurers blamed lenders for poor lending while lenders argued that the MIG policies were poorly specified and hard to claim against.

[3] These included being underwritten at the point of claim leaving open the question of eligibility. MPPI was ultimately caught up in the wider PPI mis-selling issue and where government banned cross selling of mortgages and other products.

Figure 2: Rise and fall in take up of Mortgage Payment Protection Insurance (MPPI) policies in the UK



Source: UK Finance

In 2007, the Office of Fair Trading (OFT) announced it was investigating the entire payment protection insurance market with a view to referring it to the Competition Commission, which it subsequently did. The referral and the publicity around PPI led most lenders to withdraw from the MPPI market. From April 2012, the sale of insurance at point of sale with a mortgage was prohibited by the Competition Commission. In 2012 mortgage insurance sales by banks and building societies made up some 15 per cent of sales, down from 40 per cent in 2011[4].

The partnership steering group discussed at length how it might be possible to link MPPI with ISMI (subsequently Support for Mortgage Interest, SMI). The assumption was that private insurance or personal means would provide the short-term cover for those unable to make mortgage payments. In reality insurance only covered some risks (and was underwritten at the point of claim rather than point of sale thus exposing some households to the risk that their cover would not be available when needed), while SMI only covered those who were out of work rather than with reduced incomes – the safety net as such was 'full of holes' (Ford et al., 2004).

The downturn in 2008 showed this to be the case with government moving to reduce waiting periods from 39 weeks to 13 and to increase the value of the mortgage covered by SMI to £200,000 (from £100,000), as a means for curbing the rise in possessions (see Stephens et al., 2008). A pre-action protocol was put into place which required lenders to begin a negotiation with the borrower in difficulty in line with FSA/FCA requirements and prior to taking court action.

In 2009, the Government then created the *Home Owner Mortgage Support* scheme whereby lenders were indemnified against defined losses for providing extended forbearance to borrowers who met various conditions and who had been given a full advice process. The scheme lasted around one year and helped only 62 families, albeit that some 30,000 households entered extended forbearance arrangements with their lenders outside of this scheme. The terms of the scheme were so tightly drawn it did not prove to be attractive to lenders, though the official interim evaluation did consider it to provide reasonable value for money (excluding the scheme set-up costs) for the small

[4] In 2017 the sale of life and income protection products has increased again covering perhaps 30% of buyers and on the back of the detailed mortgage advice regime now in place.

number of households concerned (Wilcox, et al., 2010). The Scottish equivalent, the *Home Owners Support Fund* encompasses both a mortgage to rent scheme and a mortgage to shared equity scheme –as such it was closer in format to the Mortgage Rescue scheme (described below). These schemes continue and have been supplemented by an End of Term Mortgage pilot which ran until the end of June 2017. This scheme dealt with borrowers with mortgages at the end of their term but who do not have the money to repay the principal sum.

The *Mortgage Rescue scheme* was also introduced in January 2009 to help buyers, who were deemed 'vulnerable' and in danger of being homeless following possession, to become renters or shared equity holders. This proved rather more popular, and in the period to the end of March 2012 it had enabled just over 4,000 home owners to remain in their homes (HCA, 2012). The scheme was closed to new applicants in 2014, even though it was seen by the industry and others as a useful and more permanent policy instrument. The official interim evaluation found that the scheme had some fairly substantial initial capital costs, and in overall cash public expenditure terms the unit cost was £45,000 per household (as a 30-year net present value). However the evaluation also found that in resource terms the scheme cost no more than the likely costs to government that would result from the households being repossessed. It also suggested that savings could be achieved relative to the costs incurred in the initial years of the schemes operation (Wilcox, et al., 2010). A subsequent evaluation by the National Audit Office (NAO) in 2011 was more critical stating;

> "The Department made assumptions about the level of demand for the Mortgage Rescue Scheme and made the wrong call. There was more need than expected for more expensive support and less for the relatively low cost rescue option. Spending more than expected and delivering less means that the Department has not provided value for money."[5]

The NAO report also included a useful graphic, replicated in figure 3, which summarises the interventions made in this period as a cross government repossession 'safety net'.

Following a lengthy Mortgage Market Review (MMR), new regulatory arrangements for home owner mortgages were introduced by the Financial Standards Authority (the forerunner to the FCA) in 2013. These reinforced the financial pressures from the Basel III provisions, to effectively restrict the provision of both high loan-to-value (LTV) and loan-to-income (LTI) mortgages, and also required lenders to be more rigorous in their scrutiny of mortgage applicants' incomes and outgoings. All these measures were introduced with a view to reducing the number of new home buyers at risk in the event of a subsequent downturn.

Despite all its limitations, SMI is still by the far the most significant government intervention providing direct support to home owners in financial difficulties with their mortgage.

In overall terms the numbers of owners supported[6] peaked at 235,000 in 2009/10 (the previous peak was 555,000 in 1993) and then declined down to 136,000 in 2015/16 with a forecast of 124,000 in 2017/18 (See Figure 4). In cost terms SMI costs peaked at £563 million in 2009/10 (the previous peak was £1,016 million in 1995) then has fallen in subsequent years to £280 million in 2015/16 (and a forecast of £266 million in 2017/18).[7]

Reflecting the widely divergent experiences in the UK, in Northern Ireland a Mortgage Repossession

[5] Amyas Morse, head of the National Audit Office, 25 May 2011

[6] By SMI, for claimants of all qualifying means tested benefits (DWP).

[7] Wilcox et al., (2017), Tables 109 and 113, UK Housing Review, Chartered Institute of Housing.

Figure 3: National Audit Office cross-government repossession 'safety net'

More targeted initiatives

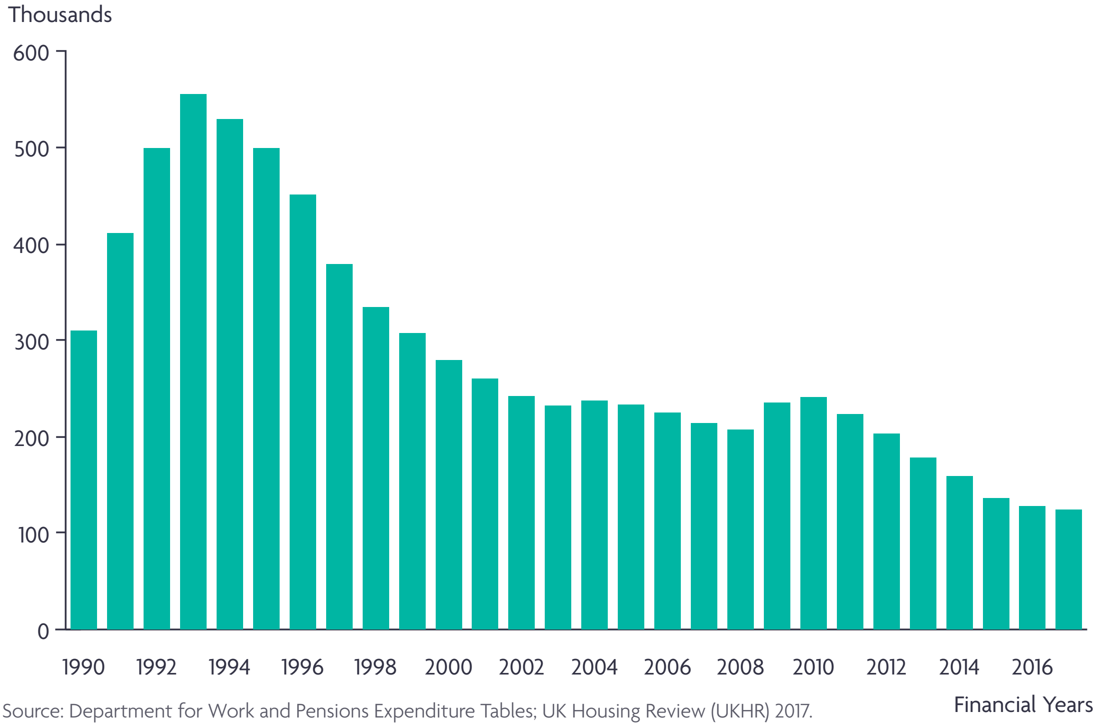
Intervention	Lead Department	Introduced	Description
Mortgage Rescue Scheme	Department for Communities and Local Government	January 2009	Aimed at preventing repossession of only the most vulnerable households that would be accepted as statutory homeless.
Repossession Prevention Fund		April 2009	A £20 million fund for local authorities to implement discretionary measures to protect vulnerable households from the immediate threat of repossession at a maximum of £5,000 per household.
Homeowner Mortgage Support Scheme		April 2009	Available to households experiencing an 'income shock' but not eligible for other sources of help. Designed to facilitate a temporary reduction in mortgage payments for a maximum of two years until income is restored with the balance payable on deferred terms. Intended to help up to 42,000 households, but take-up was limited. The scheme closed as planned in April 2011.
Enhanced court desk service		April 2008	Ensured availability of free legal advice and representation across the country for people facing possession action in the courts.
Enhanced Support for Mortgage Interest	Department for Work and Pensions	January 2009	A part of the overall benefit entitlement for around 223,000 claiments in receipt of certain benefits. Enhancements temporarily froze the payment rate at 6.08 percent, reduced the waiting period to 13 weeks and raised the mortgage cap to £200,000. The payment rate was changed in October 2010 to 3.63 percent based on the Bank of England published average mortgage rates. The enhancements to the waiting period and the mortgage cap are funded to January 2013.
Mortgage Pre-Action Protocol	Ministry of Justice	November 2008	Sets out guidance from the judicary on the steps that lenders are expected to take before bringing a possession claim in the courts with the aim of ensuring that repossessions are a last resort.
Regulation of Sale and Rent Back market	Financial Services Authority	June 2010	Following a report by the Office of Fair Trading in October 2008, the Financial Services Authority has consulted on and introduced regulations that firms offering sale and rent back have to adhere to.

Less targeted, market-wide initiatives

Source: National Audit Office[8]

[8] https://www.nao.org.uk/wp-content/uploads/2011/05/10121030.pdf

Figure 4: Decline of Support for Mortgage Interest (SMI) caseload



Source: Department for Work and Pensions Expenditure Tables; UK Housing Review (UKHR) 2017.
Notes: Years are financial years, figures for the years prior to 2004 are based on the May of each year.

Taskforce was set up as recently as 2014 to report on the problems in the province given the sharp and sustained fall in house prices. Its final report in 2015 set out a number of proposals for the future including centralising the fragmented structure of support building on the existing Mortgage Debt Advice Service.

Changes to SMI

In 2015 it was announced in the Budget that, from 2018, SMI would cease to be a grant and would become a loan with a charge being placed on the recipient's mortgage. The expectation is that the borrower will repay the amount received, plus interest, either when their income stabilises e.g. by getting back into work or when their home is sold.

From 2018, SMI will, in effect, become Loans for Mortgage Interest (or LMI for short). This provision will apply to existing claimants (but only for any claims they make from that date), as well as to new claimants.

In addition the waiting period was re-extended from 13 to 39 weeks from April 2016. The original cut in waiting period for SMI is one of the things credited with helping people stay in their homes following the recession. SMI is available on the interest on loans up to the value of £200,000 (£100,000 if on pensioner credit though there is no 9 month waiting period).

Since 5 January 2009, SMI has only been available for 2 years to new Job Seekers Allowance (JSA) claimants. In addition for all SMI claimants any payments received may be reduced if the home is considered to be more expensive or larger than needed.

Universal Credit

The availability of in-work tax credits is also important for home owners, particularly in the absence of any in-work benefits to assist home owners with their mortgage costs. Tax credits provide a partial cushion for home owners who suffer a substantial drop in their incomes from employment, such as when one partner loses his or her job while the other remains in work.

The levels of income provided through tax credits are sufficient to permit a household to cover a modest mortgage of around £40k, while leaving them with a disposable income above the levels of baseline welfare benefits such as JSA and Income

Support (Wilcox, 2003). However, with the roll out of the combined Universal Credit (UC) scheme across GB, planned to be completed by 2022, the tax credit regime will come to an end.

Under the UC scheme the SMI (and subsequently LMI) element will only be available to those claimants entirely out of work. SMI (and from 2018 LMI) will also continue to be available to pensioners in receipt of pension credit, though of course by then it will be a loan rather than a grant.

The only provision for working age home owners with any labour market participation – however little - as part of the UC regime is the higher level of 'work allowances' – that is the earnings they can retain above basic UC allowance levels, before their UC entitlement is subject to a means tested taper. However those higher work allowance levels were significantly reduced by the 2015 Budget, to zero for single and joint claimants without dependents, and £397 per month for all other home owner claimants, compared to £192 per month for tenant claimants.

The larger work allowance for home owners would potentially provide cover for a £43,000 mortgage, at current interest rates (based on a 25 year annuity). At £205 this is much lower than average levels of mortgage interest payments, which stood at £277 per month in 2015/16.[9]

The limitations of the UC scheme, as compared to the current tax credit regime, in terms of the support it provides to home buyers in low paid work can be illustrated by the simple example of a couple with two children, with one person in full time work at the level of the minimum wage. Under the tax credit regime the couple would be able to cover the costs of a £123,000 mortgage, and still have a residual income just above Income Support scale rate levels. Under the UC regime they would only be able to cover the costs of a £79,000 mortgage to be left with the same level of disposable income.[10] The extent of mortgage cover would, however, reduce in both cases in the event of any rise in interest rates. The differences between the tax credit and the UC regimes are even greater for lone parent households. A further range of comparative examples of the relative support provided by the two schemes to mortgage borrowers in low paid work are set out in Appendix 1.

This reduction in the support provided to households in low paid work is also being introduced when, as a result of both labour market trends and previous restrictions on welfare benefits, there has already seen a sharp rise in the numbers of low paid working households assessed to be living in poverty.[11]

It should also be noted that in a low interest rate environment the repayment element of average total mortgage payments is larger than the mortgage interest element. Thus the average repayment element of a mortgage in 2015/16 was £348 per month, giving a total average monthly mortgage payment of £625 per month.[12] This further illustrates the limitations of support for mortgage holders under the new UC regime, and the much greater financial strains this will leave for home owners that do fall into difficulties, and the greater pressure this places on lender forbearance and other measures if those households are to be assisted to remain in their home.

A summary of the differences between the current tax credit and benefit regime and the UC regime, and between SMI and LMI, including the timetables for these changes, is set out at Appendix 2.

[9] Office for National Statistics (2017), *Family Spending in the UK: financial year ending March 2016*. Office for National Statistics.

[10] Authors' calculations based on the 2017/18 benefit regime, a forty hour working week with a £7.20 per hour minimum wage, and a standard 25 year annuity mortgage with a 2.41% interest rate. The calculations make a £20 per week (£10 per child) allowance for the value of free school meals

[11] See, for example, Hick, R & Lanau, *A (2017) In-Work Poverty in the UK: problem, policy analysis and platform for action*, Cardiff University.

[12] See 9 above.

The wider context

Finally, in response to the credit crunch and subsequently, there have been some developments in the private insurance market, with a number of schemes being offered on the market. However the take-up of such schemes seems to be at a very modest level.

These schemes include forms of mortgage indemnity guarantees that offer protection to lenders (and in some cases also to borrowers), mortgage payment waiver products, MPPI-type cover which is now really income protection, and forms of mortgage rescue such as allowing households to rent the home they were previously buying (sale and leaseback). One scheme saw a slight premium added to the cost of the mortgage which then pays for an insurance product to cover payments. The FSA and the OFT issued joint guidance on payment waivers which opens the way for the use of this product (FSA/OFT, 2013).

We have also seen the development of an assisted voluntary sales process (Wallace et al., 2011) which flowed out of work on unsustainable home ownership.[13] In this process, lenders work with borrowers to secure a sale to a landlord and to keep the family in their home. Most recently the FCA has banned the automatic capitalisation of mortgage arrears[14] as a consequence of the BoS v Rea judgement.

In conclusion

This summary gives some sense of the scale of the interventions for home owners in difficulty that had been put in place by 2009 (see Bennett, 2009) and the subsequent progressive erosion in what might be termed the formal safety net. Even so, arrears and possessions have continued to decline and now remain at historic lows so that the overall impact of these changes in terms of support to borrowers in difficulty have, to date, been minimal.

Looking back at our categorisation of safety net approaches our summarised review of UK policy is:

1. During the crisis of the early 1990's responsive approaches were put in place. Most of these required the industry to engage with mortgage borrowers to address issues of arrears and the avoidance of eviction.

2. After the financial crisis the government attempted to put in place an insurance system (MPPI) led by the industry - however this was ineffective. They also limited eligibility for ISMI so the responsive elements of the safety net were reversed.

3. During the global financial crisis ISMI and other support measures were improved.

4. However, since then there have been numerous reductions in the value of housing specific support for those facing financial difficulties and more generally for those in low income employment. There have also been reductions in more general welfare payments.

5. On the other hand there has been increasing emphasis on ensuring greater stability in the macro-economy and the mortgage market.

6. Thus the shift has been away from individual safety nets towards more structured avoidance of mortgage risk - suggesting that, were there to be another crisis, responsive instruments would again need to be put in place.

[13] Sometimes into formal mortgage to rent schemes but not exclusively.

[14] https://www.fca.org.uk/publication/finalised-guidance/fg17-04.pdf

The Current Outlook

There are a number of factors at work in the current benign outlook.

First interest rates have continued downwards both in terms of the Bank Rate and mortgage rates. This has eased debt servicing pressures on households and possibly allowed for debt redemption - though the evidence for this is weak. In addition a number of other factors are also likely to have contributed to an improvement in households debt / repayment position. These factors include the decline of interest only mortgages, the move to capital and repayment mortgages (which with low mortgage rates means capital repayment are accelerated in the early years), the lengthening of mortgage terms and continued house price gains resulting in improved LTVs for most borrowers which allows access to better refinancing deals.

Moreover, the reality is that expectations of interest rate rises remain muted – the industry's heightened anxiety in the earlier part of this decade that we would see rapid and sustained rate rises has diminished – views as to what the new normal in terms of mortgage rates might be have lowered towards 4% (the Bank of England's own reported new normal Bank Rate going forward is 2%).

Second, the affordability of all new regulated mortgages post the implementation of the new rules in 2014 have been subject to a 3% interest rate stress test. This is to increase the likelihood that borrowers have some capacity to cope with rate rises.

Third, the tighter MMR rules also include more extensive affordability assessment and not least in terms of evidencing and documentation. This has resulted in some potentially vulnerable households being excluded and who on the basis of reasonable assumptions might have been amongst the more vulnerable households in the event of a downturn.

Conduct and prudential intervention

The 3% stress test flows out of the housing market macro-prudential tools put in place via the Financial Policy Committee (FPC) at the Bank of England and the Prudential Regulation Authority (PRA) (in relation to Buy to Let).

As part of this, another key measure has been introducing a loan to income (LTI) limit which requires that the PRA and the FCA ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at a loan to income ratio at or greater than 4.5 times (it only applies to lenders who extend more than £100m per annum in residential mortgages).[15] In a recent evaluation of macro-prudential regulation the CML (Pannell, 2017) arrives at the following conclusion – 'the FPC may be limiting credit risks at the expense of shrinking overall activity and contributing to a less diverse cohort of borrowers. This may, in turn, be adding to market illiquidity and concentration risks'.

Obviously the focus of these measures and others is very much around systemic risks to the housing market and to the financial system. However, they do have safety net consequences in that they shrink lender exposure and by extension borrower exposure. At the same time, given that the incidence of borrower difficulty is often related to unforeseen events such as unemployment or sickness, no amount of regulation can protect everyone always – at an individual level there will always be risks.

Moreover, the efficacy of these interventions has yet to be tested in a downturn so it is difficult to say precisely what effect they will have but the expectation is clear. A recent International Monetary Fund (IMF) review of five countries (Hong Kong SAR, the Netherlands, New Zealand, Singapore, and Sweden; Darbar and Wu, 2015) suggests 'it is too early to gauge the full impact of the measures that have been undertaken' but goes on to argue 'there is some early evidence

[15] This flow agreement limit has recently been made a little more flexible.

that the implementation of macro-prudential measures have enhanced banking system resilience and helped reduce the build-up of housing sector leverage in the cases reviewed.'[16]

In its June 2014 *Financial Stability Report* (FSR) the Bank of England highlighted the 'increasing use of macro-prudential policies to reduce risks associated with the provision of mortgage debt'.[17] Measures have included limits on loan to value (LTV) ratios, loan or debt to income (L/DTI) ratios, debt-servicing ratios (DSRs) and loan terms. The Bank noted that an IMF survey of over 40 countries (Lim et al., 2011) found that more than one third had implemented product tools on mortgages, including two thirds of EU countries. The question ultimately is whether such measures which are primarily about controlling risks to the financial system and the economy, also prove to be significant factors in helping manage the risks faced by individual households. Also, can lenders reasonably assume that by having such measures in place, no policies and processes, over and above the pre-action protocols and Mortgage Code of Business (MCOB) rules, are required?

The Bank of England's most recent FSR (BoE; November, 2016) highlighted the currently high household debt relative to income and that an increase in unemployment to 8% could double the proportion of vulnerable households (defined as households with mortgage debt servicing ratios of 40% or greater). Highlighting the rise in house prices relative to incomes and the increase in higher LTV lending post the crisis[18] the Bank noted the impact this had on consumption patterns. In the review the Bank assesses the impact of 2014 mortgage market recommendations - the LTI flow limit which restricts the share of new mortgages at LTIs of 4.5 or greater to 15% and the 3% stressed affordability test. The conclusion reached is that the measures have had only a 'modest effect on mortgage lending to date' partly because lenders had already adopted these standards and that they 'had not been excluding a significant number of prospective mortgagor from the market and their effect on loan size had been modest.' The flow limit had not been reached (15%) and there had been no significant increase in application rejections or in loan term length (as borrowers sought to reduce the LTI impact by lengthening terms) while first time buyer numbers had increased (though the Bank ignores the impact of Help to Buy).

The Bank concludes the measures remain appropriate and strengthen 'resilience in the face of adverse income and unemployment shocks' (the latter estimated as a 2/3% rise in unemployment). Thus while the Bank does not use the terminology of safety nets it does see all of this as building a safety margin into the system.

A wider view

Wallace's review '*Home-owners and Poverty: A Literature Review*' published in 2016 highlights a number of general trends which are of significance to this review.

First, half of all poor households were in home ownership rather than renting.[19] The proportion of poor working age households in home ownership is rather lower at 42% (of which just over a half had a mortgage), while the proportion of poor pensioners in home ownership is much higher at 85% (of which the great majority did not have a mortgage). Second, households fall out of home ownership for similar reasons to entering poverty, and are most at risk in the earlier years of ownership, due to labour market problems, relationship breakdown, indebtedness, and lower incomes.[20] Third, despite the uncertainty regarding rising base rates in the near future, home owners overall were better prepared for a rate rise. However it was suggested a significant pool of lower income home owners may also be encumbered with unsecured debt and are particularly vulnerable to further income or economic shocks.

In relation to sustainability, Wallace noted that in the last downturn Northern Ireland went

[16] See also Avouyi-Dovi et al., (2014), Cassidy and Hallissey (2016), ESRB (2016), Hartmann (2015), Kelly et al., (2015)

[17] See also Cerutti et al., (2015)

[18] Though this is modest in comparison to pre- crash level.

[19] See also Burrows, R & Wilcox, S (2000), *Half the Poor: Homeowners with low incomes*. Council of Mortgage Lenders. All figures given are on a 'Before Housing Costs' measure. In all cases the proportions of poor households in home ownership is somewhat lower on 'After Housing Costs' measures.

[20] And with low rates the risk period is extended.

through the worst crisis (and this continues to a significant degree as reflected in widespread negative equity and higher levels of possessions) but that elsewhere in Britain the lower volume of arrears and possessions reflected historically low Bank rates, government interventions and changed lender forbearance practices.

At the same time while the rate of mortgages three months or more in arrears did not exceed 2.5 percent of the mortgage balance outstanding, between 5 and 8 percent of mortgages were subject to forbearance mechanisms during 2012 (FSA, 2012) and only 44 percent of home owners who lost their home due to mortgage costs did so because they were repossessed by lenders that year. A further 56 percent sold their homes voluntarily to avoid or remedy mortgage arrears.

Moreover, among all existing households, in the period 2005-2008, the number of home owners who sold up to alleviate payment problems (246,000) was far in excess of those who experienced formal (55,000) or voluntary repossessions (80,000).[21]

The evidence cited by Wallace, showed the central causes of difficulties were loss of hours or pay, job loss or reduced self-employment earnings although ill health and relationship breakdown remained important. In addition secondary borrowing and bankruptcy or other debt management arrangements were found to complicate sorting out mortgage arrears for borrowers and lenders alike.

English Housing Survey (EHS) data showed the lower the income the more likely respondents were to be in mortgage arrears, with 9 percent in the lowest income quintile in arrears compared to 0.2 percent in the fifth highest quintile (DCLG, 2015). The FSA Mortgage Market Review showed that borrowers who were more likely to have mortgage arrears were those that had self-certified their incomes, the self-employed and those with previous credit impairment, and to much lesser degree those with high LTVs. Right to buy purchasers were also reported to be two or three times more likely to accrue mortgage arrears than other borrowers. Wallace concludes;

> "Further moves to once again expand the tenure must be contingent on securing adequate social protection for home owners who face the increasing precarity of the labour market, particularly for younger households; extended debt burdens, not least because we have a low inflation environment; and borrowers and lenders have fewer tools to apply to any new income shocks for individuals or the wider economy."

A further key point to be drawn out from this review of the evidence is that home buying households primarily fall into mortgage difficulties because of unanticipated changes of circumstances which cannot be fully eliminated by the more robust approach now being taken by lenders in respect of income assessment, the stress test, LTVs and LTIs. These will help reduce the more obviously exposed households but it will not be sufficient to prevent arrears and defaults.

In its December 2016 forecast of the mortgage market, the CML suggested that mortgages 2.5% or more of the mortgage balance outstanding at end period[22] will rise from 93,000 in 2016 to 100,000 in 2017 and 110,000 in 2018. Possessions were projected to rise to 10,000 in 2017 and 13,000 in 2018, up from 7,900 in 2016. The 2017 numbers were all revised downward suggesting that the outlook was less negative at least in the short term albeit the numbers are still rising.

As at the end of 2016 there were around 11.1 million loans on lenders books. Within this, 1.9 million were Buy to let (BTL) loans and the remaining 9.2 million homeowner loans. Within the homeowner mortgage stock, UK Finance has detailed data on 8 million regulated loans outstanding at the end of 2016. This data shows that over 3.3 million had an indexed LTV of less than 50%. The overwhelming majority of the 1.2 million missing from this database will be pre-regulation (advanced before October 2004), and therefore almost all at lower LTVs.

In previous downturns detailed research has shown that high LTV and arrears and default are correlated.[23] So the fact that, in total, over 4.5 million of the 9.2 million homeowner loans are

[21] See Ford, J et al., (2010) *Giving up homeownership: a qualitative study of voluntary possession and selling because of financial difficulties*, DCLG, London

[22] Arrears are on the basis of the percent of the mortgage balance as it is viewed as a more accurate measure and not subject to the impact of interest rate changes in the same way as a calculation on the basis of the number of months in arrears is.

[23] Though arrears and defaults are higher, only a small proportion of high LTV loans end in repossession. Loans at 100% or more are notably more risky (see FSA, 2012, datapack).

currently at these low LTVs is a significant risk mitigant.

The remaining circa 4.7 million homeowner loans that are above 50% LTV will have been largely taken out in more recent years. Since April 2014, the FCA's Mortgage Market Review rules require most new loans to have affordability stress tested against a higher interest rate. As at the end of 2016 over 2 million of the loans still on book are identified as having been stress tested in this way.

Both the LTV profile and level of stress testing set out above give some sense of the relatively low scale of exposure across significant parts of the market.

We also know quite a lot about how the profile of borrowers has changed over the last decade in relation to their borrowings, employment status and credit history drawing upon FCA Product Sales Data (PSD).

Table 1 compares 2006 and subsequent years using this PSD data. The evidence of contraction and change is very clear - the number and proportion of people with an impaired credit history, or with loans of 90% LTV or more (both all and FTBs) or who are self-employed has gone down, in some cases quite sharply. 2013 was included to capture the last full year before MMR came in (in April 2014) and it is evident that lenders were still in very conservative mode following the market collapse.

Table 1: The changing characteristics of new mortgage borrowing, number and percent, 2006-2016 H1

	2006	2013	2015	2016 H1
Borrowers with impaired credit history	92,687 4.00%	2,074 0.22%	4,901 0.48%	2,334 0.44%
Loans of 90% LTV or more, all borrowers	305,131 13%	24,386 2.6%	90,576 9%	46,818 9%
Self Employed borrowers	391,540 17%	95,820 10.2%	101,820 10%	54,302 10.5%
Total loans made	2,325,243	936,691	1,010,146	519,226
Loans of 90% LTV or more FTBs	122,543 32%	13,875 5.5%	61,789 21%	31,478 21%
Total number of FTBs	373,330	253,471	290,347	144,782

Source: FCA Annual PSD Mortgage Data

This table suggests that the population of borrowers today is likely to be less diverse than it was in the mid-2000s, a conclusion also reached in the CML evaluation of macro-prudential tools (Pannell, 2017). That in itself may then reduce overall risk levels in relation to a downturn though we should not forget the dominantly random nature of who gets into difficulty. Moreover, even if this is helpful, there is probably a significant cohort of borrowers who have heightened risk, for example, we have Help to Buy equity loan borrowers who now have an equity loan to repay alongside their mortgage. We also have very few borrowers with any form of protection if they should become unemployed and going forward we will have only very limited state safety net protection (in the form of LMI and UC). In addition we know that the household savings ratio is at a record low.

Further ahead there is inevitably much greater uncertainty, not least given the inevitable uncertainties surrounding the outcome of the Brexit negotiations. Moreover in the event of this, or any other factor, resulting in a severe shock to the UK economy and mortgage market, the cushion provided by interest rates falling from 5.7% in 2008 to under 3% in 2016, is unlikely to be available next time around.

If the relatively benign navigation of this last downturn has clearly been a factor in the government's thinking and its subsequent actions to erode much of the current/future safety net, this begs the question of what form of safety net might be needed in the event of a less benign future economic and housing market environment.

Safety Nets; a Comparative View

If the UK safety net is being eroded what is the position in other countries?

Here we have taken two approaches to clarifying trends in other countries - examination of secondary data mainly from international organisations and more detailed analysis of a number of countries with developed mortgage and housing markets, based mainly on expert commentary. The countries included are Australia, Canada, the Czech Republic, Denmark, France, Germany, Hungary, Ireland, the Netherlands, Norway, Portugal, Slovenia, Spain, Sweden and the USA.

Secondary material

The OECD has lately produced an Affordable Housing Database bringing together responses from all OECD member states. This includes relevant material on housing allowances across all tenures and on public spending in support of home ownership. The data are however incomplete and it is often unclear whether no response means no policy.

The housing allowance data[24] show that some 33 OECD countries, of which 25 are in Europe, responded that they had housing allowances in place for low income households in the rented sector. In some cases this is only in the private rented sector because rents may be set in relation to income in the social sector or a supply side subsidy is seen as adequate.

Around a half of these countries also had in place housing allowances for low income owner -occupiers (including 12 of the 25 European countries). In addition one (Denmark) had them only for OAPs; Switzerland had them in some cantons. Some other types of help for owner-occupiers were also mentioned in response to the question notably non-housing specific assistance and help with maintenance costs. As noted above the UK currently has only limited SMI support for out of work owners, and only higher work allowances for home owners as part of the Universal Credit scheme now being introduced.

The OECD also collected information on public spending on financial support for home buyers in three categories:

1. Grants - which is by far the largest form of support and is mainly about increasing access for first time buyers of different types.
2. Mortgage subsidies and guarantees which are in place to reduce interest rate costs by providing potential support should problems arise. These aim to reduce the costs of home ownership by de-risking lending and are again to support access to home ownership. They do not directly help those facing problems.
3. Mortgage relief for over-indebted home owners, which is of the most direct relevance to this review. Only this last category is limited to assistance to those in financial distress.

The OECD[25] data shows that some 7 European countries used a form of guarantee, covering a variety of groups - as do for instance Canada and the USA. As already noted, the vast majority of this assistance is in place to support access to home-ownership by reducing risks to lenders.

[24] http://www.oecd.org/els/family/PH3-2-Key-characteristics-of-housing-allowances.pdf

[25] http://www.oecd.org/els/family/PH2-1-Public-spending-support-to-home-buyers.pdf

Only 8 countries responded to the final question on helping those in financial distress[26] (including 5 European countries - Hungary, Ireland, the Netherlands, Norway, and Portugal). They identified particular schemes including subsidies to mortgage interest payments; contributions to paying off arrears; postponement of payments; refinancing; and mortgage to rent. There were no instances of formal write-downs.

To a degree we can use the data from OECD and other seconday sources to supplement the material received from country experts to identfy support in the categories set out in the introduction. To this end we have constructed three tables which summarise this information.

Detailed examples

We asked a range of country experts about the experience in their countries with respect to three groups of policies:

- shorter-term measures that are put in place by government and/or the industry when there are major problems in the mortgage market - such as around 1989/90 and after the financial crisis;
- the traditional approaches put in place either by government or the industry to address changes in individual circumstances notably loss of income through unemployment; sickness accident etc. and
- longer term regulatory changes often related to macro-prudential stabilisation policies which aim to ensure that those who buy can maintain their mortgages when circumstances change.

The tables below summarise the main responses as well as material from secondary sources.

Table 2 gives an indication of the types of responses to crises that have been observed across a range of countries. In this context the countries fall into three main categories:

- those countries where there have been few problems in the past and experienced few problems during and after the global financial crisis. In these countries, little or nothing has changed in terms of how the individual is treated in the face of unexpected problems;
- those where there were crises in the past – notably Australia, Canada, Portugal and Sweden where the policies put in place in response have been enough to address the issues raised after the global financial crisis. However, in all these cases there were anyway few mortgage arrears and possession problems so the historic approaches cannot really be said to have been tested; and
- those who suffered severe housing market problems associated with much wider financial crises. In these countries governments usually put in place an often hurried range of measures to limit foreclosure, to restructure mortgage payments and sometimes to transfer the household or the dwelling into the rental sector.

Some of these approaches have been supported by subsidy or tax reliefs - but quite often the costs were transferred to the industry. Some were far too detailed and inflexible to be of much help. Many have become more formalised and become part of more general regulation; others have been restructured; and others have simpy disappeared.

In the main it would be difficult to argue that coherent safety nets had yet been put in place whichever category a country falls into. Where there is little experience of problems, it is assumed problems will not occur. Where untested changes are in place, there is little incentive to change. Where there have been major problems (notably Ireland; to some degree the Netherlands and Spain) processes are still in flux.

Table 3 describes the position with respect to

[26] http://www.oecd.org/els/family/PH2-1-Public-spending-support-to-home-buyers.pdf, Table PH2.1.3

Table 2: Responses to crises across a range of countries

	Enable rule changes	Direct Subsidies	Require the industry to adjust	General attitude
Australia	Early release of superannuation benefits on compassionate grounds - mortgage assistance (Australian Government) Mortgage relief loan (Queensland Government)		Requirements to consider variations in contracts when a borrower is in hardship Remediation when hardship the result of poor lending practices	These are general rules which are not new but have been clarified or tightened in response to post global financial crisis concerns. But individual problems as result of global financial crisis have been limited
Canada	Mortgage rate renewal protection introduced in response to high interest rates in 1980/1		Mortgage law has strengthened consumer protection e.g. on foreclosure	Few problems experienced – hardly impacted by global financial crisis and little discussion of need for safety net
Czech Republic				Some measures discussed but none put in place
France	Introduced a buy back scheme to transfer those in financial difficulty into social housing after the 1989/90 crisis			No concerns after the global financial crisis and no changes to support or available insurance against changing household circumstances
Germany				No specific measures associated with crisis
Hungary	National Asset Management Programme for residential dwellings Debt management service Prolonged moratorium on foreclosure	Early repayment at a discount exchange rate Transfer to rent with subsidised rents for lowest income households	The cost of early repayment scheme laid on banks Plus additional costs of interest and exchange rate increases	Extreme crisis in mortgage market caused mainly by foreign exchange loans Part of overall 'unorthodox' financial policy

	Enable rule changes	Direct Subsidies	Require the industry to adjust	General attitude
Ireland	Forbearance Deferred interest scheme – pay 2/3 and park the rest Mortgage to rent scheme	Limits to penalties for mortgage arrears Subsidy support to first time buyers with LTVs over 80% to be introduced in 2017	Lenders must have dedicated staff and a published policy on addressing arrears	Massive problems in mortgage market as part of overall financial crisis
The Netherlands	Extended mortgage guarantee scheme Enabled to let out original home if unable to sell and had purchased a new home	Can continue to receive mortgage interest relief on remaining debt on sale, and make no repayment for 10, now 15 years.	Help to both lenders and mortgage borrowers through national guarantee scheme	Very significant crisis because of negative equity and incapacity to sell property in 'dead' market
Portugal	In response to earlier crisis: modifications of loan conditions, postponement of mortgage payments			Because of response to earlier crisis very few problems of default and arrears
Slovenia				No new measures although discussion of FTB guarantees
Spain	Massive range of interventions at national, regional – and industry – level including: restructuring / back loading debt by moratoria on principal for up to 3 years; plus possibility of renting for 2 years	Direct subsidies in Catalonia	Industry pays the costs associated with the changes in rules	Many mortgage borrowers; politicised approaches to remediation etc. Part of wider financial crisis
Sweden	Debt reconstruction rules have been made slightly more generous		1991/2 crisis lenders renegotiated loan terms	Not hard hit by crisis so no additional measures
USA	Hardest Hit Fund established in 2010 in 18 states and the District of Columbia, through modifying conditions	Also mortgage payment assistance, and transition assistance programs		Problems of arrears and default dealt with differently across states

Source: Lunde and Whitehead, 2016; Whitehead and Williams, (2017) and comments from country experts often based on national government and central bank publications.

housing allowances and more general income support measures.

The main message is that housing specific allowances are often not available to owner-occupiers. Rather they are expected to depend on general unemployment support; death, sickness and other loss of income protection. If there are high costs and no reversal of the situation, owner-occupiers are normally expected to adjust their housing costs by selling. The exception in some countries seems to be divorce or other family circumstance changes where the emphasis is more on finding negotiated ways forward. In countries where emergency constraints have been put in place these will then apply. However, in the main, there is a clear tension between ensuring the general rules are imposed as compared to helping people in individual crises.

Table 3: Income related housing assistance to owner-occupiers

	Housing allowances for owner-occupiers	Other forms of assistance for changing circumstances
Australia	No	Unemployment and sickness benefits not related to costs
Canada	Varies between provinces	Unemployment and sickness not related to costs Insurance against income loss and illness – including deferred payments Asset tests for welfare payments so must sell home
Czech Republic	Yes	Income support supplements for housing costs
France	Yes	Unemployment and sickness benefits not related to costs
Germany	Yes	Unemployment assistance /health care insurance replaces high proportion of income Not forced to sell
Hungary	No	Home maintenance allowance
Ireland	No	Fuel allowance
The Netherlands	No	National mortgage guarantee
Norway	Yes	Unemployment and sickness benefits not related to costs
Portugal	No	Unemployment and sickness benefits not related to costs
Slovenia		Unemployment and sickness benefits based on incomes not expenditures
Spain	No	Unemployment and sickness benefits not related to costs
Sweden	Yes for families; pensioners; young people	Unemployment and sickness benefits not related to costs
USA	No	

Source: Lunde and Whitehead, 2016; Whitehead and Williams, (2017) and comments from country experts often based on national government and central bank publications.

Across countries most of the emphasis since 2008 has been on introducing regulatory changes that have limited the industry's capacity to make higher risk loans or increased their costs to the institutions.

These constraints in turn affect who can obtain a mortgage and so impact on future risks. This is not a safety net in itself but reduces the need for safety nets to be put in place – at least with respect to the mortgage market. However, as noted in our review of instruments this increases the need for support in the rented sector and at the limit, for homeless households.

Table 4: Regulatory changes impacting on mortgage markets

Country	Significant regulatory change since 2008	Specific macro-prudential rule changes such as maximum LTV	General approach
Australia	Limited change. Macro-prudential management by the Reserve Bank Regulations to improve underwriting standards	No formal rules	Stronger guidance including stress tests
Canada	Tightened mortgage market regulation mainly to limit access	Eligibility rules for insured mortgages tightened and a stress test introduced	
Czech Republic	In line with EU banking regulations	Recommended limits on LTV New Act to enable Bank to set maxima	Government guarantees to support immature mortgage market
Denmark	Increased regulation to limit systemic risk	Maximum 80% LTV in place	Advisory constraints on down payments and interest rates on high LTV loans etc.
France	Very little change in either regulation or underwriting criteria	No maximum LTV and borrowing above 100% with guarantees	Some additional advice in line with Basel regulations
Germany	Conservative system has remained in place	Possible law to allow the discretionary use of emergency instruments (capital ratios, LTV maxima and LTI rules)	In line with Mortgage Credit Directive
Ireland	Nationalisation of all Irish banks after 2008 Main objective to keep mortgage borrowers in difficulty in their homes 2015 central bank put in place macro-prudential regulations	80% maximum LTV put in place in 2015 (90% for first time buyers). LTI at 3.5 times income	

The Netherlands	Temporary regulation of mortgage credit introduced in 2012 and tightened lending rules	Government agreement with banks to limit LTV maximum from 120% initially to 106%, and to 100% in 2018. LTI rules also put in place	Slow adjustment to tightened regulatory process Changes in mortgage tax relief – removed for interest only mortgages
Norway	From 2010 financial supervisor required deposit of 10% and now 15%	LTV maximum of 85% but can go to 100% in certain circumstances An annual repayment of 2.5% required on all loans over 70%	Borrower must pass a stress test
Portugal	2009 Action Plan for Risk of Non-Compliance notice from EC	No additional mortgage regulation	If anything moving towards easier lending
Slovenia	2016 Bank of Slovenia issued macro-prudential recommendations	From 2016 guidance is 80% LTV; LTI from 50% to 67% (for higher income households)	Industry standards tightened since 2008
Spain	A number of legislative changes as part of overall restructuring of banking system and - stronger underwriting rules	No formal requirements - 90% of residential loans are under 80% - but house price falls have put many into negative equity	Working towards implementation of the Mortgage Credit Directive
Sweden	Increasing regulation from 2010	Maximum LTV of 85% Amortisation now required on higher LTV loans LTI caps discussed	Internal bank models generate extremely low risk weights so little incentive to modify behaviour
USA	Substantial tightening and strengthening		Rollout of Dodd-Frank Act 2010 to curb predatory lending techniques and ensure lenders retain some risks

Source: Lunde and Whitehead, 2016; Whitehead and Williams, (2017) and comments from country experts often based on national government and central bank publications.

Table 4 includes all forms of financial regulation, and from the individual's point of view is almost wholly focussed on initial affordability and the possibilities of higher mortgage costs (especially through the increasing use of stress tests).

As such, it does little to protect individuals from unexpected changes in income, which is the most usual source of arrears and possessions. Where incomes fall for unexpected reasons, the first port of call in most countries is unemployment and sickness benefits as well as welfare payments where incomes fall below certain minima. In the main, these take no direct account of specific expenditures such as mortgage payments.

However, in many Western European countries, levels of out of work benefits, and especially those that are linked to previous earnings levels, are far higher than in the UK and so remove the need for measures specifically related to mortgage costs (Ditch, J et al., 2001).

The evidence from other countries suggests that, where the mortgage payments are not being kept up to date, the most usual approach is to ensure appropriate negotiations take place between mortgage lender and borrower to restructure payments, e.g., to extend the mortgage and to backload payments to a time when the borrower can pay. In a number of countries the government now requires institutions to put the framework for such negotiations in place. In some they also require that the institutions subsidise individual mortgage borrowers.

When this category of assistance is not enough, owner-occupiers will normally be required to sell their property or be assisted into the rental sector where housing allowance assistance is more usually in place. At the limit, the owner-occupier will be evicted and be dependent on broader safety nets.

Finally, when unexpected events occur which impact on large numbers of households, it is clear governments take emergency measures in response to the specifics of the crisis mainly with the aim of keeping the status quo in place until such time as the market has recovered.

Conclusions

This review has been undertaken over a short space of time, drawing in large part on the experience of the authors and contributors. It has been revealing to look again at home owner safety net arrangements and policies and to explore how much they have changed in the last decade.

On some measures, the UK mortgage market is less exposed to the risks of arrears and possessions than it has been in the past reflecting not least a range of regulatory interventions. However, the public safety net provided by government to support individual borrowers in difficulty has itself largely disappeared.[27] Some safeguards remain, e.g., court procedures, but in terms of formal programmes to support borrowers in difficulty this has for the most part been removed or is in the process of being removed.

The emergence of a range of macro-prudential controls and regulation should have reduced the number of households who might be most exposed to a downturn. However the wider macro-economic context of economic uncertainty, wage increases at a lower rate than inflation, along with a medium term likelihood of interest rate increases, now 10 years since the MPC increased rates, does suggest a less positive outlook.

Households have become very used to enjoying low and falling mortgage rates and many have extended their secured and unsecured debt despite static wages. The Bank of England rightly reminds us that this poses significant risks.

So the picture is quite mixed: on the one hand a number of major risks and on the other the current situation is quite benign and there is little sign of deterioration plus there are some controls in place to limit the flows of what might be deemed the 'worst' risks into the mortgage market.

What we now have in place

At the level of the individual home buyer in the UK, by 2022 there will be little in place that offers financial support or protection. SMI will have been replaced by LMI. In addition Universal Credit will have replaced tax credits and will offer more limited support (in the form of some higher work allowances) for home owners that face a loss of income, or can only find re-employment in low paid work. These provisions are very modest and will offer very little benefit to the borrower or re-assurance to the lender.

Ultimately, although the safeguards that exist for borrowers in terms of regulatory requirements/treating customers fairly, via court procedures and the potential for re-negotiation with their mortgagee remain in place, there is little from the government side that might incentivise lenders to do more than follow due process.

One point to note here is that the limitations of support available to mortgage holders through LMI and in UC are such that inevitably these will result in a higher level of possessions than would otherwise be the case, and where the households affected find themselves in the social or private rented sectors the government will incur costs in the form of housing benefit. These potential costs to government should be a factor when considering the construction of a more effective home owner safety net.

From a lender perspective, we can ask whether lenders themselves are prepared to deal with the eventuality of more extensive borrower default in the event of a downturn.

With shrinking arrears and possessions numbers, most lenders will understandably have reduced their staffing in this area. There must already have been a loss of expertise and although some knowledge may still remain within the corporate memory there must be a risk that any recovery of this capacity will lag behind any increase in case loads.

[27] Northern Ireland, Scotland and Wales seem to have more in place than England though some local authorities in England and the other countries have intervention programmes in place - as do some housing associations. The focus is often on buying back homes they previously sold.

This report offers lenders and government an opportunity to reflect on whether current arrangements are sufficient.

It is not unreasonable to suggest that the risks to borrowers of arrears and possession are increasing even though the actual numbers are still falling. It is possible that these risks will become material in the next five years and at a point when the UK is still coping with the consequences from Brexit. A significant housing market decline at this point would be unhelpful and potentially, at least partly, avoidable if the right safeguards are in place. Thinking about this now would be very sensible and building some capacity back into the system would seem a prudent safeguard.

Clearly the macro-prudential and regulatory controls remain in place and tightening the mortgage system to exclude people with poorer incomes/credit histories will help to build in a degree of resilience to rate increases.

However, we should not forget that arrears and possessions often arise for complex and very individual reasons. Overall, the expectation in government seems to be that lenders will exercise forbearance and that this will be the primary mechanism for overcoming a downturn. However the appetite for forbearance is likely to be both limited and conditional upon government playing its part in the process.

How does the UK compare to other countries?

Evidence from other countries suggests that, as in the UK, the main emphasis since 2008 has been on increasing the regulation of financial institutions in line with international requirements. This is mainly for macro-prudential reasons but has the direct effect of limiting the number of households at risk when circumstances, either market or personal, change.

Importantly, while income and affordability are taken into account at the point the mortgage is taken out, these do not address issues around specific changes in individual circumstances such as sickness, unemployment or income loss except as a side-effect of stress testing. Actual problems are sometimes covered by insurance but are mainly addressed by general support that is based on remaining income and takes no account of specific costs such as mortgage repayments. If this leaves the mortgage borrower in financial distress, then it is normal for there to be negotiation between the borrower and the lender, often within a framework specified by the regulator or government legislation. At the limit, owner-occupiers face eviction and move to the rental sector, where they usually benefit from a stronger safety net at greater government cost.

One issue that stands out from international as well as UK experience is that specific safety nets tend to be put in place only in response to crises. Further they may not survive until the next crisis, which itself may have very different attributes.

More generally, the international evidence suggests that the need for mortgage-specific safety nets depends in large part upon the generosity of the broader system of income support. There are two obvious differences between the UK and many other countries. Firstly, social security here is less generous and less likely to be related to past levels of income as it is in many Western European countries - so more households are likely to face difficulties in meeting their housing outgoings. Secondly, and partly as a result, the UK is more generous than many other European countries in providing support to distressed owner-occupiers and more generally treats housing differently from other essentials in a way which is quite unusual in comparable countries.

A mortgage specific safety net system has thus proved necessary here in the past and is likely to be required at some point in the future.

Future prospects

The scaling back of safety net arrangements for home owners presents a worrying picture of where we are now and will be by 2022 on present plans.

While there are few pressures on lenders in the current benign market circumstances, the planned policies are so scant as to raise serious concerns about their limitations in a less benign environment, and in particular in the event of any future housing market and economic downturn.

The current outlook is for a tightening of market conditions, as rate rises start to come through over the next five years. We would argue that now is the right time to prepare for that, both to make provisions for households that encounter unpredictable adverse changes of circumstances (that cannot be prevented even with more rigorous initial credit assessments), and for the wider risks to the industry and the economy that would arise in the event of any major economic and housing market downturn.

While the case can be made for a far more comprehensive home owner safety net, such as the Sustainable Home Ownership Partnership (SHOP) scheme advocated by the Joseph Rowntree Foundation a few years ago, there is currently no political appetite for schemes with that degree of market intervention.

Within the current framework, adjusting the Universal Credit work allowances might be helpful at least to those home owners able to return to work, as well as contributing more widely to a reduction in levels of in-work poverty. The switch of SMI (as a benefit) to LMI (as a loan), will provide government with a modest saving in the years from 2018. However it would only cost a little more to extend its availability to Universal Credit claimants in low paid work. Indeed, such a provision would reduce the case for home owners having higher working allowances than tenant households and might even result in further savings to government.

There is also a case for developing a countercyclical 'package' ready to roll out in the event of a downturn which could be accessed by local authorities and housing associations.

Alongside any fund are also all the 'soft' measures that might be 'dusted off'. The report by the Behavioural Insights Team for the Northern Ireland Government (BIT, 2015) was focussed on encouraging early engagement by borrowers with mortgage arrears and set out a whole series of ways the process of arrears handling could be improved. The CML statement of practice on arrears and possessions was effectively superseded by MCOB though its good practice note on delivering good customer outcomes in pre-arrears and arrears, the guidance on assisted voluntary sales and most recently on the BoS v Rea court case around the automatic capitalisation of mortgage arrears do provide an important context for such a discussion.

The issues around a safety net will not go away even if government has moved to curtail support. As the UK moves forward into a period of considerable uncertainty, there is clearly a case for a fresh re-examination of the issues.

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Appendix 1

Maximum mortgage that could be supported by Tax Credits and Universal Credit without reducing household residual income below Income Support baseline levels

	Tax Credits			Universal Credits		
Single Person	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£147.94	£207.77	£242.59	£147.94	£207.77	£242.59
Income Support Baseline	£73.10	£73.10	£73.10	£73.10	£73.10	£73.10
Weekly Available Income (3)	£74.84	£134.67	£169.49	£74.84	£134.67	£169.49
Monthly Available Income (3)	£325.18	£585.14	£736.43	£325.18	£585.14	£736.43
Mortgage Cover (4)	£72,585	£130,612	£164,383	£72,585	£130,612	£164,383
Couple without children	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£188.13	£242.68	£264.47	£128.71	£191.11	£237.09
Income Support Baseline	£114.85	£114.85	£114.85	£114.85	£114.85	£114.85
Weekly Available Income (3)	£73.28	£127.83	£149.62	£13.86	£76.26	£122.24
Monthly Available Income (3)	£318.40	£555.42	£650.10	£60.22	£331.35	£531.13
Mortgage Cover (4)	£71,072	£123,978	£145,111	£13,442	£73,962	£118,556
Lone Parent with One Child	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£290.82	£328.49	£348.85	£235.62	£265.49	£280.37
Income Support Baseline	£172.20	£172.20	£172.20	£172.20	£172.20	£172.20
Weekly Available Income (3)	£118.62	£156.29	£176.65	£63.42	£93.29	£108.17
Monthly Available Income (3)	£515.40	£679.08	£767.54	£275.56	£405.35	£470.00
Mortgage Cover (4)	£115,046	£151,580	£171,327	£61,509	£90,479	£104,910
Lone Parent with Two Children	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£342.76	£393.31	£413.67	£291.65	£321.52	£336.29
Income Support Baseline	£249.10	£249.10	£249.10	£249.10	£249.10	£249.10
Weekly Available Income (3)	£93.66	£144.21	£164.57	£42.55	£72.42	£87.19
Monthly Available Income (3)	£406.95	£626.59	£715.06	£184.88	£314.66	£378.84
Mortgage Cover (4)	£90,838	£139,864	£159,611	£41,268	£70,238	£84,563

	Tax Credits			Universal Credits		
Couple with One Child	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£276.72	£326.99	£343.28	£259.65	£289.52	£304.29
Income Support Baseline	£209.20	£209.20	£209.20	£209.20	£209.20	£209.20
Weekly Available Income (3)	£67.52	£117.79	£134.08	£50.45	£80.32	£95.09
Monthly Available Income (3)	£293.37	£511.80	£582.58	£219.21	£348.99	£413.17
Mortgage Cover (4)	£65,485	£114,241	£130,040	£48,930	£77,900	£92,225
Couple with Two Children	Hours worked			Hours worked		
	15	30	40	15	30	40
Gross Earnings	£108.00	£216.00	£288.00	£108.00	£216.00	£288.00
Net Disposable Income (2)	£346.46	£396.73	£413.01	£329.39	£359.26	£374.02
Income Support Baseline	£286.10	£286.10	£286.10	£286.10	£286.10	£286.10
Weekly Available Income (3)	£60.36	£110.63	£126.91	£43.29	£73.16	£87.92
Monthly Available Income (3)	£262.26	£480.69	£551.42	£188.10	£317.88	£382.01
Mortgage Cover (4)	£58,541	£107,296	£123,086	£41,986	£70,955	£85,271

Notes:

1. All calculations based on 2017/18 tax and benefit scales, and hours worked at the level of the minimum wage (£7.20 per hour).

2. Net disposable income is gross earnings less income tax and national insurance, plus tax credits or Universal Credit and minus net council tax, after allowing for council tax benefit or support. In English areas with less generous council tax support schemes schemes the net disposable income, and the resulting available income and mortgage cover will be a little lower than shown.

3. The available income is that over the level of the Income Support baseline levels for each household type, which include an allowance for free school meals at £10 per child per week.

4. Mortage cover based on average rate of 2.41%, for a standard 25 year repayment mortgage. Any increase in interest rates will reduce the extent of the mortgage cover provided by either scheme. An increase in interest rates by just 1% would reduce the mortgage cover by just over 10% compared to the figures shown in the Appendix.

5. The levels of mortgage cover shown as defined in this table are far higher than would be granted for a new mortgage based on prevailing affordability assessments. This table rather shows the relative levels of safety net support available to home owners that end up in low paid work following an adverse change of circumstances.

Appendix 2

The changes from SMI to LMI, and Tax Credits and Out of Work Benefits to Universal Credit

Support for Mortgage Interest	Loans for Mortgage Interest
Payment based on eligible mortgage interest	Repayable loan based on eligible mortgage interest
Part of Pension Credit and out of work benefits (Income Support, ESA, JSA) until the end of March 2018	Part of Pension Credit and out of work benefits (Income Support, ESA, JSA) from the beginning of April 2018
	Applies to new claimants, and to existing claimants for eligible mortgage interest from 1st April onwards.

Tax Credit & Out of Work Benefits Regime	Universal Credit Regime
The Universal Credit (UC) regime is being phased in to progressively replace the current tax credit and out of work benefits, with all working age claimants currently planned to be in receipt of UC by the end of 2020/21.	
SMI (and then LMI) only paid to working age claimants working less than sixteen hours per week. Any earnings are fully deducted from any benefit entitlement.	SMI (and then LMI) only paid to claimants with no earnings, regardless of how small or how few hours are worked.
For the purposes of Tax Credits there are minimum working hours requirements, ranging from 16 to 30 hours per week dependent on the household type.	UC home owner claimants in work have a higher ‘work allowance’ (i.e. amount of earnings disregarded in entitlement calculation) than tenant UC claimants.

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