# From SMI to Mortgage Support:

## How to help struggling homeowners through the pandemic

Alex Morton and James Heywood

Centre for Policy Studies

## About the Centre for Policy Studies

The Centre for Policy Studies was recently named by Conservative MPs polled by ComRes as the most influential think tank in Westminster. Its mission is to develop policies that widen enterprise, ownership and opportunity. This paper is the first in a major series, 'Going for Growth', devoted to rebuilding Britain's prosperity in the wake of the coronavirus crisis. Founded in 1974 by Sir Keith Joseph and Margaret Thatcher, the CPS has a world-class track record in turning ideas into practical policy. As well as developing the bulk of the Thatcher reform agenda, it has been responsible for proposing the raising of the personal allowance, the Enterprise Allowance, the ISA, transferable pensions, synthetic phonics, free ports, and many other successful policy innovations. The recent Conservative manifesto drew heavily on CPS proposals, in particular its flagship policies on tax and housing.

## About the Authors

Alex Morton is Head of Policy at the Centre for Policy Studies. He was previously a Director at Field Consulting, and before that was responsible for housing, planning and local government in the No 10 Policy Unit from 2013-16 under David Cameron, including working on key policies in the 2015 manifesto. He was previously Head of Housing at Policy Exchange and has also worked in the civil service and parliament.

James Heywood is Head of Welfare and Opportunities at the Centre for Policy Studies. He specialises in tax and welfare, housing, and economic policy, with a particular focus on disadvantaged groups and places, and people on low incomes. He was previously Senior Parliamentary Adviser on Treasury and Work and Pensions issues for the Conservative parliamentary party. His work on tax and welfare has been concerned with improving work incentives for the lowest paid, lifting the poorest out of tax, and tackling in-work poverty.

## Acknowledgements

Many thanks from the CPS to the JRF and their engagement on this important issue. The authors also thank their colleagues at the CPS for support in editing, publishing, and publicising this report, as well as those in Government who gave up valuable time to discuss these issues with them. Mistakes, are, as ever, the authors' own.

The Joseph Rowntree Foundation has supported this project as part of its programme of research and innovative development projects, which it hopes will be of value to policy-makers, practitioners and service users. The facts presented and views expressed in this report are, however, those of the authors and not necessarily those of JRF.

Supported by

JRF JOSEPH ROWNTREE FOUNDATION

# Contents

# Executive Summary

## The pandemic has had a shattering impact on many families' livelihoods.

Claims for Universal Credit have shot up, and there will be more pain to come as the furlough scheme is wound down.

There is, of course, a safety net in place. But one of its main components, the provision of housing benefit, only covers those who rent rather than own. Owner occupiers can only claim for help with mortgage interest – for which they have to wait for nine months after losing work, with the whole amount withdrawn as soon as they get any form of employment.

More generally, the benefits system in the UK is hugely tilted towards those who rent rather than own – even though roughly a third of those in poverty are owner occupiers.

This paper argues there is a short-term need to improve the Support for Mortgage Interest (SMI) scheme to support home owners through the crisis – as happened in the wake of the financial crisis. Some 42% of owner occupiers have no savings, and this group will be disproportionately those on low and moderate incomes – whose savings and earnings have eroded most quickly since the pandemic began.

This is not just compassionate, but cost-effective, given that it is much cheaper for the state to cover the costs of mortgage interest than to support someone via housing benefit.

It also argues that there is a longer-term need to rebalance the welfare system to reflect the desire of a large majority of those on low or moderate incomes to achieve, and retain, home ownership, which has all manner of economic, social and psychological benefits.

**"This paper argues there is a short-term need to improve the Support for Mortgage Interest (SMI) scheme to support home owners through the crisis – as happened in the wake of the financial crisis."**

This should not involve the Government subsidising people to retain assets they can no longer afford, or to build up capital where renters cannot, but helping them cope with shocks both personal and economic.

We therefore recommend that, as the mortgage holiday that was offered at the start of the crisis comes to an end, the Government should make it as easy as possible for people to move on to the Support for Mortgage Interest scheme, which is the main element of the welfare state dealing with owner occupiers, as well as reforming the scheme to make it fit for the longer term.

In particular, we urge that:

- The nine-month waiting period for SMI should be abolished so it is available from day one

- The Government should encourage lenders to inform borrowers in arrears about the benefits of this scheme (and notify all those on the mortgage holiday of its existence). It should also encourage switches from repayment to interest-only mortgages where there is a risk of people losing their home

- The first three months of SMI should be paid as a grant, not a loan, and the Government should charge no interest on the next nine months of any claim

- The Government should be far more flexible in allowing people to claim SMI while moving into work, in order to remove the current cliff edge, and make it far more responsive to changes in people's circumstances

- There should be a two-year time limit on claiming SMI for non-disabled working age claimants

An expanded form of SMI would, we argue, be not only more compassionate towards the families involved but more cost-effective for Government. The average weekly claim for SMI is less than half the figure for housing benefit – and given that it is largely loan-based the bulk of the money would eventually be reclaimed. A very rough estimate would be that a household on SMI, under our new system, would cost the Government 10 times less than one on housing benefit.[1]

**“An expanded form of SMI would, we argue, be not only more compassionate towards the families involved but more cost-effective for Government.”**

With a difficult year ahead of us in economic terms, now is the time to make changes as the mortgage holiday draws to a close, changes that would make SMI a better overall system both then and in the longer term.

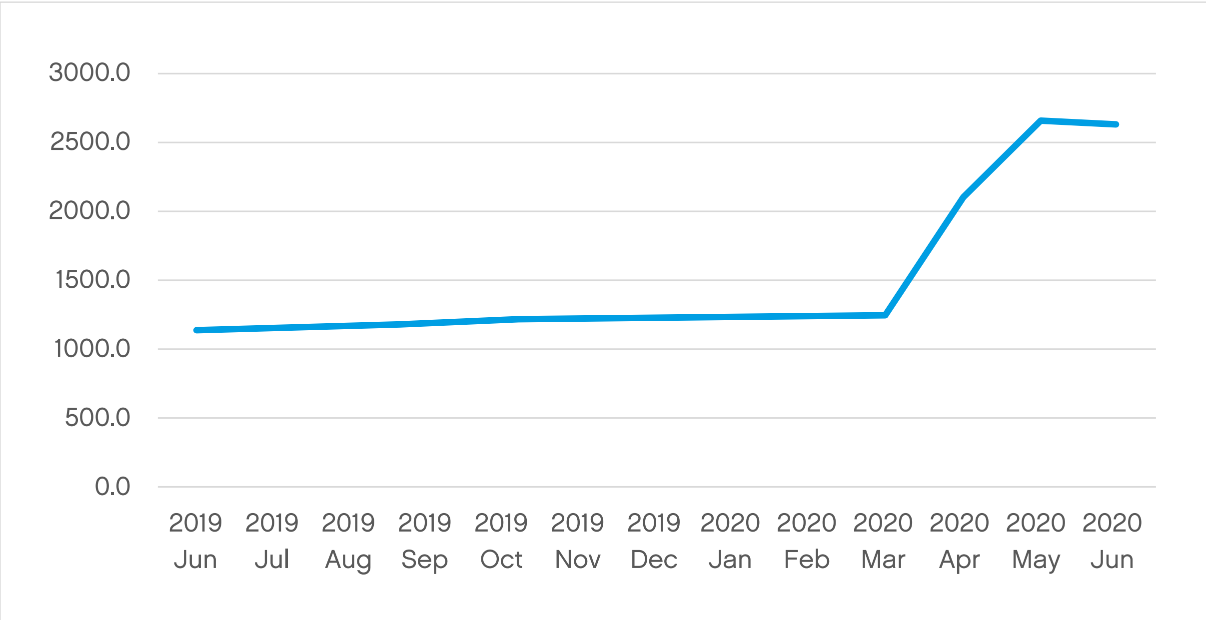
1 Assuming loan element is effectively cost-neutral, cost of grant based on average SMI claim is £40 x 13 weeks = £520 in total. Average housing benefit claim is £4,973/year. This cost is the annual cost for the first year – after this, the cost of SMI is effectively zero.

## Introduction; The impact of Covid-19 on the economy and low income homeowners has been immense.

Within weeks of the lockdown, the number of people forced to submit a claim for Universal Credit and other benefits soared.

The UK claimant count (both Jobseeker's Allowance and Universal Credit out-of-work) rose from just over 1 million in June last year to more than 2.5 million in June 2020.[2] It is expected that it will rise even further as the furlough scheme, which by mid-August was being used to furlough 9.6 million workers,[3] is wound down further and ended completely in October.

*Claimant count, June 2019-June 2020 (thousands, UK)*




*Source: ONS, Claimant Count (experimental statistics), July 2020 link*

Under such circumstances, one of the biggest fears many families face is the prospect of losing their home. There are 18 million working-age people in the UK living in a home which is owned with a mortgage.[4] The benefit system has extensive support in place for those on low incomes who rent, but a much more threadbare safety net for low- and moderate-income owners, who will struggle to cope with a fall in income or loss of a job. According to polling conducted by YouGov for the Joseph Rowntree Foundation (JRF) in May, around one in five mortgage holders were worried about their ability to pay the mortgage,

2 Thérèse Coffey, *DWP's response to coronavirus (COVID-19).* Link

3 HM Revenue and Customs, *HMRC coronavirus (COVID-19) statistics.* Link

4 Office for National Statistics, *People in households by housing tenure and combined economic activity status of household members: Table I.* Link

rising to nearly one in four of those households with children.[5]

The Government has recognised this by putting in place mortgage holiday arrangements during the pandemic, and encouraging lenders to be flexible and understanding – but the mortgage holiday will end alongside the furlough scheme. This means many who lose their jobs as furlough ends will face mortgage costs resuming at the same time.

Research by the Institute for Fiscal Studies (IFS) suggests that among furloughed workers in May and June there was a 26% fall in the numbers making mortgage payments. For those in the Self-Employment Income Support Scheme (SEISS), mortgage payment fell by around a third but recovered somewhat after the first SEISS payment was received, suggesting some self-employed people who are still unable to trade as normal after SEISS runs out may face mortgage problems.

The biggest decline in mortgage payment the IFS observed was among those making Universal Credit claims after the start of March. The share of claimants making their mortgage payments halved. Unlike with SEISS, mortgage payments among this group do not appear to have recovered. The IFS observe that this suggests that 'the receipt of UC is not sufficient to get these households paying their mortgage again' and 'does raise the question of what might happen to these households when mortgage holidays end'.[6]

As the Joseph Rowntree Foundation, which supported the publication of this paper, argued in a recent briefing note, there is an immediate need for the Government to support such families during the crisis, not least given how fragile many of their finances are.[7] In the wake of the financial crisis, the then Government introduced temporary measures to expand the Support for Mortgage Interest (SMI) scheme – the main vehicle for providing assistance to struggling homeowners – to avoid large numbers of people defaulting on their mortgages and being repossessed. There is an obvious case for similar measures today.

**"The biggest decline in mortgage payment the IFS observed was among those making Universal Credit claims after the start of March."**

But there is also, as this paper will argue, a broader need to improve the way in which the Support for Mortgage Interest (SMI) scheme operates. Support with housing costs through the welfare system is overwhelmingly focused on those who rent rather than own, even when families have similar financial situations and levels of need. This will always be the case to some extent, given that one group has assets and another does not, but it is clear that the operation of the SMI scheme could be substantially improved – which could even save the Government money given the higher short-term cost of providing social housing or paying housing benefit if a family is unable to keep their home.

5 Rachelle Earwaker, *Mortgage holders need certainty and security in the coronavirus storm.* Link

6 Isaac Delestre, Robert Joyce, Imran Rasul, Tom Waters, *Income protection policy during COVID-19: evidence from bank account data.* Link

7 Rachelle Earwaker, *Mortgage holders need certainty and security in the coronavirus storm.* Link

## How common is low-income home ownership?

When we think about home ownership, we tend to imagine that the rich own and the poor rent. But the real situation is much more complex than that.

It is true that even before the Covid-19 crisis, home ownership among low and moderate earners had been falling steadily – part of a wider pattern of decline in owner-occupation and growth in the private rental sector.

Over the decade between 2008-09 and 2018-19, almost all of the net increase in the number of households in England was in the private rented sector. The number of owner occupier households barely rose, from 14.6 million to 15 million, and the same goes for social renters, only rising from 3.8 million to 4 million. Over the same period, the number of households renting privately rose by 50%, from 3.1 million to 4.6 million.[8]

There was a corresponding rise in low- and moderate-income private renters. In 2004 only around 18% of working-age people in material deprivation were renting privately, but this has since risen to more than 30%. For households on less than 50% of median income, it has risen from just over 20% to 34% over the same period.[9]

However, this should not blind us to the fact that many households on low and moderate incomes are still home owners. As previous JRF research has shown, around a third of those in relative poverty after housing costs (below 60% of median income) are owner occupiers.[10]

The demographic group most likely to be owner-occupiers are childless couples, nearly 80% of whom are homeowners. But around 67% of couples with children own their home, while around a quarter of single parents do as well.[11] Almost all of those who buy are in work (around 60% of all owner occupiers are currently in work and 36.2% have retired, with less than 1% officially classed as unemployed).[12] This is unsurprising given that most people need a mortgage, which requires a steady income, in order to own.

> **“Over the decade between 2008-09 and 2018-19, almost all of the net increase in the number of households in England was in the private rented sector.”**

In other words, if you are rich, you are likely to own your own home: nearly two thirds (62%) of all first-time buyers are in the top two income quintiles, as are 68% of people who own with a mortgage.[13] But if you are on a low or moderate income, there is still a good chance that you are a home owner. Indeed, if we use the actual weekly cost of different tenure types as a measure of affordability, it is clear that for many people it is actually *more* affordable to have a mortgage than to be paying rent (even

8 Ministry of Housing Communities and Local Government, *English Housing Survey 2018 to 2019: housing costs and affordability: Chapter 2: figures and annex tables: Annex Table 2.4.* Link

9 Pascale Bourquin, Jonathan Cribb, Tom Waters and Xiaowei Xu, *Living standards, poverty and inequality in the UK: 2019.* Link

10 Alison Wallace, David Rhodes and Firona Roth, *Home-owners and poverty.* Link. (Using DWP ‘Households Below Average Income’ statistics).

11 Ministry of Housing Communities and Local Government, *English Housing Survey data on owner occupiers, recent first time buyers and second homes: Table FC2111.* Link

12 Ministry of Housing, Communities and Local Government, *English Housing Survey data on tenure trends and cross tenure analysis: Table FA1301.* Link

13 Ministry of Housing, Communities and Local Government, *English Housing Survey 2018 to 2019: headline report: Section 1 household tables: Annex Tables 1.3 and 1.8.* Link

in the social rented sector).[14] For example, people who receive support to put a deposit down on a home ('the Bank of Mum and Dad') have lower incomes on average than those who don't, because they are less able to save for the deposit themselves. But their mortgage payments are just as manageable – as the Social Mobility Commission has stated: 'On average, assisted FTBs in England had lower incomes and purchased a lower priced home than those who received no assistance. However, as a percentage of income the average mortgage payments of both assisted and unassisted FTBs were more or less the same.'[15]

## How precarious is home ownership?

Those on lower incomes often have relatively little in savings or other wealth to tide them over in the event of an unexpected income shock. Almost half (47%) of all households report having no savings, including 42% of owner occupiers with a mortgage (the proportion of those who own outright who have no savings is lower, at less than one in four).[16]

Even just looking at those in employment, 57% of those in the lowest quintile by income would not have sufficient financial assets to survive a 75% reduction in their income for three months. For the second quintile, this figure is still only 54%. By contrast, three quarters of workers in the top quintile would have sufficient assets to cope.[17]

This will be a particular issue in the coming months as unemployment is likely to rise further. While overall savings rates appear to have gone up during the lockdown, this does not seem to be the case for lower income households – who have also been far more likely to lose their jobs, be furloughed, or be in insecure work without guaranteed hours or where they are technically classed as self-employed.

YouGov polling for the Resolution Foundation found that just 10% of those in the lowest income quintile and 17% in the second quintile reported their savings increasing during lockdown, compared to 28% and 32% respectively who reported their savings falling. By contrast, for the top quintile more than a third reported their savings rising.[18]

**“Even just looking at those in employment, 57% of those in the lowest quintile by income would not have sufficient financial assets to survive a 75% reduction in their income for three months.”**

And obviously, mortgage payments take up a significantly higher proportion of income for people who are unemployed than for those in work. The average weekly mortgage payment for someone in full-time work is £179, according to data from the English Housing Survey, and the mortgage takes up 18% of income for this group on average. For those who are unemployed the mean payment is £123, representing 38% of income on average.[19] Obviously, the longer

14 Helen Barnard, *UK Poverty 2018.* Link

15 Social Mobility Commission, *The impacts of family support on access to homeownership for young people in the UK.* Link

16 Ministry of Housing Communities and Local Government, *English Housing Survey 2018 to 2019: housing costs and affordability: Chapter 2: figures and annex tables: Annex Table 2.10.* Link

17 Office for National Statistics, *Wealth and Assets Survey – financial resilience: Table 2.* Link

18 George Bangham and Jack Leslie, *Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain.* Link

someone is unemployed the more likely they are to no longer be able to maintain mortgage payments and so lose their home.

## Why should we support home ownership?

Before we move on to the specifics of the policy landscape, it is worth pausing to consider a key point of principle: should the state be subsidising home ownership to begin with, and to what extent?

> **“The British Social Attitudes survey, for example, has found that 88% of the public ultimately wanted to own.”**

The state already limits access to the welfare system based on your level of personal assets: for example, if you and your partner have savings of more than £16,000, you are unable to claim Universal Credit. There is a similar case that if you are unable to afford your mortgage, you should have to sell up rather than being subsidised by the state (especially given the likely capital appreciation during your period of ownership). This is why the Support for Mortgage Interest scheme is limited, as the name suggests, to interest rather than the debt itself, and why support via the scheme has always been far lower than support, via social housing, for those who cannot afford to house themselves, let alone own a property.

This is why, when we move on to this paper's recommendations, we are clear that the SMI scheme cannot be used simply to keep people living in homes they cannot afford over the longer term. Its core purpose must be to cover temporary shortfalls, uncertainties and disruptions. Yet as we will outline later, there is a huge disparity between the level of support available for renters who go through a period of unemployment or hardship compared to someone with a mortgage to pay.

And on the broader point, it is not just that – as outlined above – many of those in owner occupation are in just as significant material need as those who receive housing benefit. It is that owner occupation is beneficial in and of itself, not to mention being the public's overwhelming preference when it comes to tenure.

The British Social Attitudes survey, for example, has found that 88% of the public ultimately wanted to own.[20] This includes solid majorities across every income level: another survey found that 60% of households who earned £15,000 or less had a long-term desire for ownership; for those between £15,000 and £20,000 it was 70%; and for those between £20,000 and £25,000 is was 80%.[21]

Academic studies have also consistently pointed to a positive link between home ownership and participation in community organisations, political engagement, and social capital in general, even adjusting for income and other variables.[22] Polling shows people perceive a range of benefits from owning your own home. These include a greater sense of freedom and the sense that you can 'do what you want', as well as feeling more settled. In fact, YouGov polling for the Council of Mortgage Lenders has found that the emotional benefits and control given by ownership

19 Ministry of Housing, Communities and Local Government, *English Housing Survey data on owner occupiers, recent first time buyers and second homes: Table FA2531 (S334): mortgage payments by economic status of household reference person.* Link

20 Ministry of Communities, Housing and Local Government, *Public attitudes to house building, Findings from the 2017 British Social Attitudes Survey.* Link

21 Council of Mortgage Lenders, *Home-ownership or bust? Consumer research into tenure aspirations.* Link

22 William Rohe and Mark Lindblad, *Reexamining the Social Benefits of Homeownership after the Housing Crisis.* Link

are more commonly cited than financial considerations such as seeing a house as an investment or saving money on rent.[23] According to the English Housing Survey, those who own their home outright have an average life satisfaction score of 8 points compared to 7.4 points for private renters, and 7.1 for social tenants.[24]

It should also be stressed that this is not a peculiarly British phenomenon. You will find just as great an attachment to home ownership in most other developed countries – which actually tend to have higher rates of ownership than the UK. Eurostat data from 2018, for example, shows that our home ownership rate of 65.2% is below the European average of 69.3%. Where we are an outlier is that we still have the second highest level of social or sub-market rental housing, which in turn may be related to the soaring costs of ownership in recent decades.[25]

In short, most people still want to own homes. The difficulty, of course, is affording a home in the first place. In addition to the mountainous cost of a deposit (addressed in a recent CPS paper, Resentful Renters)[26], there is the lack of savings issue addressed above. Even if those on low or moderate incomes can access home ownership, for example via an inheritance or family assistance, there is the fear that if they lose their job they will not have the savings necessary to keep up repayments. This risk aversion can be seen, for example, in the fact that poorer households tend to hold their wealth in much less risky and more liquid assets, such as current accounts or ISAs, than better off households.[27]

Yet recent changes in the housing market also strengthen the argument for doing more to support home owners, aside from the obvious benefits to the families involved. Despite Britain's high existing stock of social housing, the proportion of people on lower incomes who rent from the council or a housing association has declined in recent years, and the size of the private rented sector has grown (as have rents).

> **"According to the English Housing Survey, those who own their home outright have an average life satisfaction score of 8 points compared to 7.4 points for private renters, and 7.1 for social tenants."**

Support for low- and moderate-income home owners that enables them to stay in their home (or at least prevents eviction and repossession) is thus likely to be a more attractive alternative for this group than moving into fairly expensive private sector rented accommodation – and the cost to the state is likely to be lower. Also, the more the private rented sector grows, the more Government subsidies via housing benefit will be going into the pockets of private landlords.

There is also a longer-run point to make, which is that those who remain on housing benefit are more likely to need support from the state throughout their lives. Those who build up assets via home ownership will have more scope to support themselves, particularly in their old age. It is therefore in the state's own long-term fiscal interest for people to be owners rather than renters, all other things being equal.

23 Council of Mortgage Lenders, *Home-ownership or bust? Consumer research into tenure aspirations.* Link
24 Ministry of Housing, Communities and Local Government, *English Housing Survey: Headline Report, 2016-17.* Link
25 Eurostat, *Distribution of population by tenure status, type of household and income group – EU-SILC survey.* Link
26 Graham Edwards, *Resentful Renters: How Britain's housing market went wrong, and what we can do to fix it.* Link
27 George Bangham and Jack Leslie, *Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain.* Link

## What support is usually available?

In normal times, state support is much more limited for low- and moderate-income home owners who find they are out of work than for those in the rental sector. The main source of welfare support, as mentioned above, is Support for Mortgage Interest (SMI).

This has the following key characteristics:

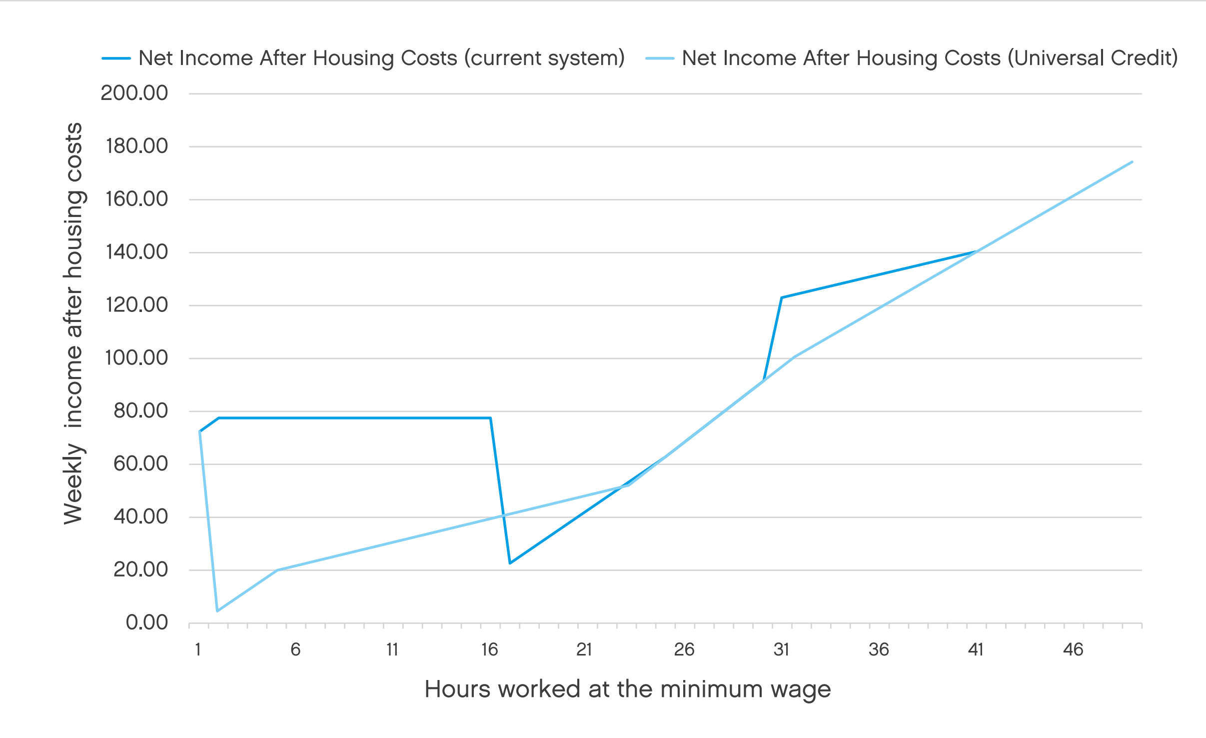
- *It is restricted to those on particular benefits and to supporting mortgage interest*

  SMI is passported, meaning it is only available to claimants of certain mean-tested benefits, including Universal Credit, Jobseeker's Allowance, Income Support, Pension Credit, and Employment and Support Allowance. SMI does not cover repayments on the mortgage principal, only on interest payments and in some cases loans for repairs and maintenance. Rather than being based on each claimant's mortgage interest rate, a 'standard rate' of interest is paid to all claimants, set based on the average mortgage rate published by the Bank of England. The current rate is 2.61%.

  There is also a 'zero earnings rule' for Universal Credit claimants: this means that if you take on any work, at all you lose all of your SMI support. It is one of the few 'cliff edges' left in the welfare system, with most of these having been abolished in recognition of the fact they

**Mortgage repayments:** £73.22, **Outstanding mortgage:** £104,888

**Net income under the current system and Universal Credit**




*Source: NPI Household Tax and benefit model, The minimum wage is for 2013-14 (£6.31) and tax and benefit values are for 2014-15.*

cause very high marginal withdrawal rates and can punish people for working.

As moving into work causes immediate loss of all SMI, a claimant can be left significantly worse off if they take on work than if they remain workless, as the graph on the previous page shows.[28]

As a result of the tight eligibility criteria in place, SMI is largely claimed by those who cannot work, rather than those who are unable to: as the chart in the next section shows, the primary claimant route is among the sick and disabled, followed by pensioners, then single parents and others who need income support, with those on unemployment benefits representing a small fraction of the total.

- *There is a waiting period before claiming*

SMI has a nine-month waiting period before support can be claimed, unless the claimant is receiving Pension Credit. This means that once someone has claimed Universal Credit (after losing their job, for example), they cannot receive support with their mortgage costs for nine months. Again, undertaking any work at all during the waiting period also means the wait will be reset in the event the claimant loses work again.

This means that claimants currently have nine months in which, if there is a prospect of some work, they must decide whether to risk taking it and have to restart their waiting period all over again if it does not work out. By contrast, support for rental costs in Universal Credit can be received with the first payment, so the only waiting involved is the wait for the first monthly payment. (Despite this, since the rollout began there have been substantial rates of rent arrears building up among UC claimants.[29])

This is not only unfair in and of itself, not least because it discourages people from seeking work, but suggests that as the mortgage holiday ends, many households are likely to get into difficulty. In normal times, they might hope for forbearance from their lender in the short term – but with many having already benefited from a mortgage holiday during lockdown, they may find lenders reluctant to go further.

**“SMI has a nine-month waiting period before support can be claimed, unless the claimant is receiving Pension Credit.”**

- *The system is based on loans, not grants*

For almost all of its lifetime, SMI was a straightforward benefit, just as renters could receive housing benefit. However, since April 2018 it has taken the form of a loan, secured against the mortgaged property. Interest is payable on the loan a claimant receives, with the rate based on the Government’s cost of borrowing (gilt rate). If a claimant remortgages or increases their existing mortgage, SMI continues to be payable but only to the same level as the original mortgage. There is no time limit on the length of time assistance can be received.

28 Sabrina Bushe, Peter Kenway, Tom MacInnes, Adam Tinson and Louisa Withers, *The minimum wage, taxes and benefits: How the minimum wage interacts with the tax and benefit system.* Link

29 House of Commons Work and Pensions Committee, *Universal Credit: the six-week wait.* Link

The loan becomes repayable in the event the property is sold, on the claimant's death (where the claimant has no partner) or on the death of the last member of the benefit unit (if the claimant has a partner).

**"According to the English Housing Survey, those who own their home outright have an average life satisfaction score of 8 points compared to 7.4 points for private renters, and 7.1 for social tenants."**

- *There is a cap on what can be claimed.*

  There is a cap of £200,000 on the size of mortgage on which interest payments can be met. You can claim support on the first £200,000 if you have a mortgage larger than this, so those who live in homes with larger mortgages can receive support on interest up to this £200,000 limit. The standard rate of interest also means that if a claimant is paying an above-average interest rate on their mortgage they may have a shortfall even after SMI has been paid (others of course may be paying a lower rate and can use the extra to cover repayments on the mortgage principal).

It is worth highlighting that there is a slightly different version for claimants who are entitled to SMI by virtue of being entitled to Pension Credit. These do not have to serve a waiting period, but the capital limit for the mortgage they can claim for is £100,000 rather than £200,000. Otherwise the rules apply to this group as with working age claimants.

## What has been done to help during the pandemic?

There have been a range of policies introduced in order to support homeowners during the Covid-19 crisis. In March, as the situation worsened, the Government announced that mortgage holders would be able to request a mortgage holiday for three months to help with the impact of the coronavirus on employment and incomes. More than 1.8 million mortgage payment holidays were taken up after this initial announcement.[30] A temporary ban on home repossessions was also put in place. There were also informal efforts to persuade lenders to treat borrowers with flexibility and understanding.

In May, lenders were persuaded to offer an extension to those taking up the mortgage holiday for a further three months, taking it from the end of June to the end of October. The period in which it would be possible to make a new claim was also extended. It is worth pointing out that these levels of forbearance are much higher than was the case during the financial crisis, probably because in the initial period of the lockdown it was hoped that this would be a temporary period of disruption and things would go 'back to normal' later in the year.

It seems clear, however, that support will be required for significantly longer than was initially anticipated. The Government's Job Retention Scheme, which allows employers to furlough workers will be coming to an end at the same time as the mortgage holiday, at the end of October (of course some may continue to benefit from a mortgage holiday for a while beyond this, subject to their lender's discretion). Few doubt that the end of the furlough scheme will be accompanied by job losses, as there will still be employers unable to pay all or

30 HM Treasury, *Help with mortgages to continue for homeowners affected by Coronavirus.* Link

even some of their staff due to depressed demand in some sectors.

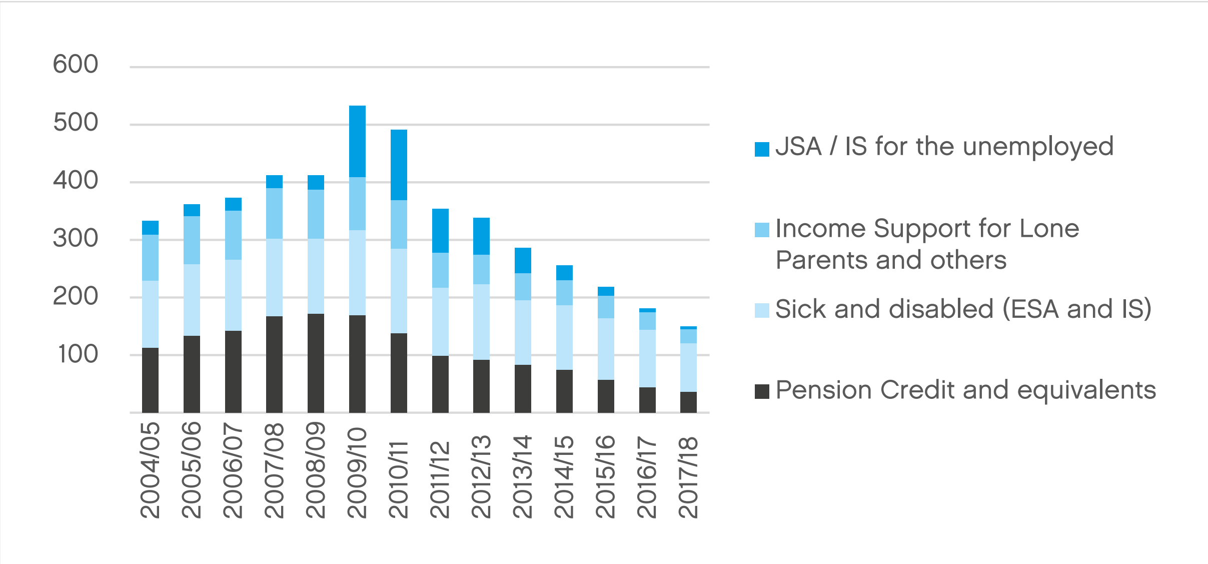
People taking up a mortgage holiday have also been accruing interest on their mortgage and will have to deal with the backlog of deferred payments once the holiday ends. As the JRF has argued, it would be crippling to many households to be presented with this as a lump sum.[31] But many will likely see an increase in their monthly payments, possibly for years to come, depending on discussions with their lender.

## What level of support should home owners receive in future?

There is clearly a precedent, as noted earlier in this paper, for short-term changes to the SMI scheme to accommodate the impact of an economic shock. In January 2009, for example, it was amended to help people affected by the financial crisis and subsequent recession: the waiting period was reduced from nine months to 13 weeks, and the loan cap increased from £100,000 to £200,000 for new claims from those of working age.[32]

We can see from the chart below that SMI played an important role during that crisis as a cushion for those falling on hard times: not only did spending increase to more than £600 million, but the proportion of claimants receiving unemployment benefits went up significantly. It is likely that the level of support that is required in the ongoing aftermath of the Covid-19 crisis will be much higher as well.

**Support for Mortgage Interest expenditure, by income replacement benefit type, 2004-2018 (£m)**




*Source: DWP Benefit expenditure and caseload tables 2020, link*

It is also worth noting two important points. The first is that the subsequent fall in costs was not due to the expiring of the measures introduced in 2009, since in fact the cut in waiting times was rolled over until March 2016 while the new £200,000 cap has remained in place permanently. The fall reflected the general decline in

31 Rachelle Earwaker, *Mortgage holders need certainty and security in the coronavirus storm.* Link

32 Wendy Wilson, Steven Kennedy, Richard Keen, *House of Commons Library Briefing: Support for Mortgage Interest.* Link

unemployment and income support, as well as the reduction in those reliant on SMI while receiving pension credit, as prosperity returned. It also reflected a policy change in 2010 when the Coalition began basing the standard rate on the Bank average, reducing it from 6.08% to 3.63%, and rates then continued to fall in the following years. The second point, similarly, is that 'short-term' changes, in response to emergencies, often have lasting effects.

Overall, however, the most striking thing about that chart is the relatively small amount of spending involved – which is incredibly small when compared to other parts of the welfare system.

Now that it is loan-based, the SMI system is counted as costing almost nothing to government (write-offs are estimated to cost £1-2m per year).[33] But even in the final year before it became a loan, spending was just £156 million.[34]

Compare that with the level of support for renters on similar incomes – a system which is not seen as being incredibly generous in most cases.

The UK's system of support for renters, via housing benefit and the housing element of Universal Credit, is one of the largest elements of the entire welfare system. Indeed, in 2018 the annual bill was around £22.3 billion.[35]

Private sector tenants can claim a grant up to the level of the 'Local Housing Allowance', a system based on the market value of the area you live in and taking account of household size. In response to the pandemic, these rates have been increased to the 30th percentile of local rents, effectively reversing the impact of the four-year benefits freeze and other previous measures which had reduced LHA rates relative to the 30th percentile.

There are of course limits on this: single claimants under 35 with no children are subject to the Shared Accommodation Rate, meaning they can only claim for the cost of a room in a shared property, and in the social sector there are size criteria to take account of any empty rooms when calculating eligible rent. Some may also have support limited by the caps on the overall amount a household can receive in benefits, currently £20,000 for a couple or single parent (£23,000 in London). But you can receive housing benefit even if you are in work, to help top-up your income, whereas if you are a lower-income homeowner you do not receive support.

**"Now that it is loan-based, the SMI system is counted as costing almost nothing to government (write-offs are estimated to cost £1-2m per year)."**

Likewise, if you lose your job and have to move on to Universal Credit, you can claim support straight away as a renter with no real wait. Even if the benefit cap would apply to you, most people benefit from a nine month 'grace period' before it is applied (and it is also lifted if your or your partner work a certain amount each week).

For those at the bottom of the housing market, in other words, the system is in no way tenure-neutral. Low income renters

33 Department for Work and Pensions, *Benefit expenditure and caseload tables 2020.* Link
34 Wendy Wilson, Steven Kennedy, Richard Keen, *House of Commons Library Briefing: Support for Mortgage Interest.* Link
35 Department for Work and Pensions, *Benefit expenditure and caseload tables 2018.* Link

can receive support in work, can increase this support instantly if they lose work, and receive support as a grant rather than a loan to cover the whole cost up to a cap. None of these are true if you are low- or moderate income homeowner. Furthermore, as a tenant you are not expected to pay for repairs, while your landlord can claim back some of the costs incurred renting to you via the tax system. In the case of social housing, this is paid for by housing associations, at a cost of £3.2 billion.[36] Local authority spend on housing repairs and maintenance is around £1.8 billion, giving a total of £5 billion.[37]

> **“Local authority spend on housing repairs and maintenance is around £1.8 billion, giving a total of £5 billion.”**

Given that the numbers of those in poverty divide by 2:1 in terms of renters: owners, then purely on the grounds of fairness, you would expect spending on benefits for home owners to be a respectable proportion of the level for renters. Instead, it is a small fraction of the total.

So what should be done? One obvious solution would be to make the system as tenure-neutral as possible, by increasing support for home owners to match that given for renters. But there are severe problems with increasing government subsidy to one sector to match the other – aside from the extremely high cost.

The first and most obvious point is that this would require the Government to turn SMI back from a loan into a grant. Having only just changed the system after more than half a century, they are unlikely to be willing to do so, not least because of the added expense involved. When the Government contacted existing SMI claimants about the switch to a loan structure, more than half declined the offer of an SMI loan and a further 25% were undecided, with less than a quarter accepting.[38] As of May 2020, the proportion who have declined a loan had increased to 77%, with just 20% having actually accepted and signed for a loan.[39] Reversing this move would, accordingly, drive up the claimant count.

Similarly, if SMI were extended to cover not just mortgage interest but housing costs more broadly, it would risk a surge of claimants over time. More importantly, paying the principal of a mortgage down permanently is fundamentally different from temporary support to those who need a roof over their head. As discussed earlier in this report, it is unfair to expect those on low incomes to save extensively, which is why greater support is necessary. But if you buy a house at the very edge of your affordability, and then cannot afford to make payments for a long period of time, you should probably consider selling your home to access the equity within it, or moving to a less attractive property or area. Clearly, no one benefits if they are given a mortgage they cannot really afford if they are to later become a victim of repossession.

36 This consists of routine maintenance, planned maintenance, and major repairs expenditure; Regulator of Social Housing, *2018 Global Accounts of private registered providers.* Link

37 Department for Communities and Local Government, *Local Government Financial Statistics England: No.27 2017.* Link

38 Department for Work and Pensions, *Conversion of Support for Mortgage Interest from a Benefit into a Loan: claimant communication and intention to take up a loan.* Link

39 Department for Work and Pensions, *Conversion of Support for Mortgage Interest from a Benefit into a Loan: claimant communication and intention to take up a loan.* Link

There is also a likely impact on house prices. Creating a situation where people expand the level of credit they can access, and in which those with mortgages they cannot afford are able to remain in those homes for longer periods, would mean house prices will be higher than they otherwise would be. Of course, other methods of supporting ownership may have impacts on house prices, and there are other constraints on credit (e.g. the Bank of England's regulatory system), but our goal should be to support people in difficulty without putting upward pressure on house prices.

In short, if you are a low-income home owner, or even on moderate income, then it is hard to conclude that the system is sufficiently supportive to those like you. There is clearly a need to make the housing system more sympathetic to owner occupiers – who are, as we have stressed, a third of those in relative poverty after housing costs are taken into account.

But reform should not consist of simply moving to a system for owners that mirrors the system for housing benefit claimants. And the goal should not be to keep everyone in the home that they live in. If you have bought a home that you cannot afford in the long term, it is not the job of the government to keep you in that particular home permanently. It is the job of government to ensure that you have a roof over your head, and that if you do have to sell your home and move to another one, that you have the time and space to do so in an ordered way that minimises the pain and trauma, and does not risk you losing your carefully built up equity though repossession.

In other words, for claimants who are able to work SMI must remain a temporary support, rather than a longer-term crutch. However, it is important to stress that any potential support for home owners should not just focus on the lowest earners. While they are not the poorest group, if those on moderate incomes fail to keep their home in a period of turmoil it can be more difficult for them to get back onto the housing ladder in future. If we refuse support to moderate-income owners and they end up seeing their home repossessed, particularly if this happens in a chaotic fashion, it may well be a catalyst for other changes around family breakdown, mental health problems, and other long-term issues. So it makes no sense to have too sharp a cut-off between those on low and those on moderate incomes.

**“If you have bought a home that you cannot afford in the long term, it is not the job of the government to keep you in that particular home permanently.”**

## What should the new system of support look like?

The impact of the pandemic on people's incomes will mean that many homeowners will temporarily be struggling with their mortgage payments. Without adequate support, some will be forced out of their homes and into renting, which could be more expensive anyway.

At the same time, there is a longer-term case to be made beyond the immediate circumstances of the pandemic that better support for homeowners going through tough times could mean more people on low incomes owning rather than renting. That is better for them – and cheaper for the Government as well.

In May 2018, the average weekly claim of private sector housing benefit was £95.64, or £4,973 a year.[40] By contrast, SMI is

40 DWP Housing Benefit Tables: *Table 5: Housing Benefit claimants average weekly award by tenure: November 2008 to May 2018.* Link

currently cost-neutral in the long run, given that is a loan-based system and the write-offs involved are so small: the Government almost invariably recovers its costs when the property changes hands.

During the last recession, the number of housing benefit claimants reached 1.65 million. It is impossible to quantify the number of claimants who might be supported in ownership rather than having to rely on housing benefit, but if only a fraction of this group were able to rely on SMI rather than housing benefit during the current recession, this would generate substantial savings.[41] For example, if 50,000 households were able to stay in their homes thanks to SMI, rather than being pushed into renting, it would represent a welfare saving of roughly £250 million. In addition, it would be far more popular with the families themselves.

**“During the last recession, the number of housing benefit claimants reached 1.65 million. It now stands at around 1.2 million.”**

We would therefore argue that there is scope for a substantial reform of the SMI scheme to provide a better safety net, both in the current crisis and in future. It would be marginally more expensive than the current scheme, but by retaining tight eligibility criteria the added costs would be limited. But it would, we believe, be much fairer in its structure – on the one hand to mortgage holders who fall on hard times, and on the other to those who cannot afford to own and are forced to rent.

Importantly in the current context, it would also be likely to reduce the risk of widespread repossessions. DWP research found that the more generous system of SMI introduced in 2009 made lenders more likely to agree reasonable payment plans with claimants and less likely to seek repossession: a 2011 paper concluded that the changes ‘provided an added impetus to lenders to forbear, and advisers found that lenders were more willing to negotiate about converting mortgages to interest only arrangements and/or concessionary payments to address shortfalls’.[42]

We therefore propose a series of changes that together would fundamentally improve the Support for Mortgage Interest scheme and make it a more comprehensive and effective way to help low- and moderate-income home owners without excessively increasing the cost.

1. **Abolish the wait for access**
   The current nine-month wait could lead to substantial arrears being built up, and cause financial distress for some low-income mortgage holders for years to come. As a starting point, those people still in need of support after October should be able to move straight onto SMI after the end of their mortgage holiday.

   This is particularly important for people who might want to take on a job that may not be guaranteed in the long term. Claimants will worry that if they take a job that only lasts a few months, they will have a long waiting period all over again before they can get support with the mortgage if they need it.

   Our preference would be for this to be a permanent change, rather than a

41 DWP Housing Benefit Tables: *Table 4: Housing Benefit claimants by tenure: November 2008 to May 2018.* Link

42 Janet Ford, Alison Wallace, Moira Munro, Nigel Sprigings and Susan Smith, *An evaluation of the January 2009 and October 2010 arrangements for Support for Mortgage Interest: The role of lenders, money advice services, Jobcentre Plus and policy stakeholders.* Link

temporary crisis measure. It is not clear why people should be expected to survive a considerable amount of time before they can receive support, other than that the government hopes this will mean those who are only unemployed short-term will be excluded from the scheme. Cushioning a temporary period of difficulty should surely be a principal purpose of SMI. The stress of dealing with the mortgage with no government support at all for nine months may also hinder efforts to actually move back into work.

**“Our preference would be for this to be a permanent change, rather than a temporary crisis measure.”**

2. **Make SMI the first resort before repossession**
   Where lenders are considering repossession, or where a borrower moves into arrears, lenders should be required to talk to the borrower about the SMI system and, if possible, help them to access it. There is also a case for the Government or lenders to write to all those currently benefiting from the mortgage holiday to make them aware of the SMI scheme. The reason is that SMI is one of the least-used and least-known parts of the welfare system – and those who do know about it may also be aware of the tight conditionality. Increasing awareness that there is support out there may have a cost in the short term, in terms of higher take-up, but will help many families while cutting housing benefit bills in the longer-term.

   In addition, the Government could consider if there are ways that they can support temporary movement to interest-only mortgages, or at least ask banks to put this forward as an option where low- and moderate-income homeowners are having difficulty keeping up with repayment mortgages due to sudden loss of income.

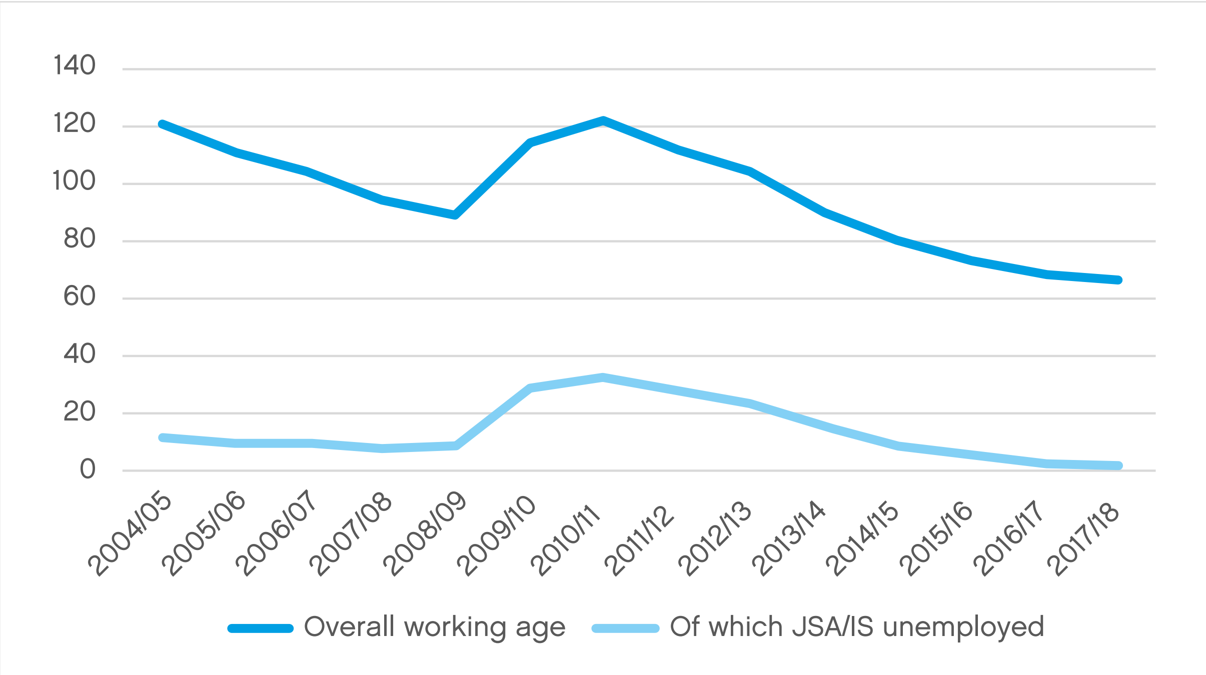
3. **Temporarily offer a three-month grant rather than a loan**
   As outlined above, we believe that SMI should remain loan-based rather than grant-based, not least because the Government will not want to increase its long-term spending commitments at a time when the public finances are so hard-pressed. At the same time, this crisis is clearly going to put very significant pressure on many households, through no fault of their own – and there is clear evidence from the transition in 2018 that people are more reluctant to take on ‘debt’ via a loan than to claim a benefit.

   It is not fair that mortgage holders should have the costs of their owner-occupier status met indefinitely by the taxpayer when others on similar incomes can only get support with their rent. But we want to avoid a situation where some who may be back into a job relatively soon and could stay in their homes with a little temporary support ends up selling up because they are concerned or confused about how this extra debt would work.

   We therefore recommend that the first three months of SMI are paid as a grant rather than a loan. Given that the current average payment for interest costs is £40 a week for working-age claimants, this would only mean a grant of roughly £500 per claimant over the full 13 weeks. Even if claims significantly increased due to Covid-related job losses and a million new claimants joined, that would be an outlay of roughly £500 million in a unique period of economic shock – which would of course be compensated for by savings in housing benefit. If we take that 50,000 figure above, the grant would cost £25 million vs housing benefit savings of £250 million. Even if the grant element were retained past the crisis (as we would prefer), the cost would be relatively small: the number of working-age SMI claimants has never exceeded around 120,000, and that was after the financial crisis, when there was a three-month wait but SMI was also fully grant-based.[43]

It is important to stress that this recommendation, and others, are subject to the DWP's computers being up to the job: given the need to deliver support rapidly, it would be counter-productive to bring in any changes which required months of tinkering with the systems. We are optimistic that these changes would not be excessively demanding, but if they were then we urge the DWP to explore alternatives that have the same effect of lowering barriers to claiming during the current crisis.

**Working age SMI caseload, 2004-2018 (thousands)**




4. **No interest should be applied until a claimant has been in receipt of SMI for two years.**
As noted above, a key reason claimants have been reluctant to stay on SMI when converting from grant to loan has been the fear of building up a 'debt', particularly when interest is being applied. It seems reasonable to apply a relatively modest level of interest eventually (the rate is based on gilt rates, which are at historic lows and have been for some time), to reflect the cost to government of providing the support. But giving claimants two years before interest begins to accrue would give them a grace period in which to stabilise their position without worrying about a new debt building up. A two year interest-free period would also

43 Department for Work and Pensions, *Benefit expenditure and caseload tables 2020.* Link

align with the time limit for non-disabled working age claimants suggested in point six below.

5. **Scrap the zero earnings rule for the first six months of employment.** The zero earnings rule means that those who have seen significant reductions in their income and are struggling to meet their mortgage commitments, such as those with significantly reduced hours, will not be able to claim SMI: only those who have actually lost their jobs and become fully unemployed are able to claim. At a time when we desperately want to see more people working and avoid high long-term unemployment, the last thing policy should be doing is penalising people for moving back into work on a part-time basis.

   Given that SMI is intended to help people through temporary shocks, we would not want to see people claiming from the scheme once they were back in employment – but we do not want to disincentivise or punish them from seeking work, or give them uncertainty around their finances. We therefore propose that, for the first six months of employment, the zero earnings rule should be removed. We also suggest that SMI be made available to UC claimants who are working less than 16 hours per week and whose partner works less than 24 hours, mirroring how the system used to work for JSA claimants.

   There are a number of potential ways of implementing this. One option would be to simply pay full SMI to any claimants working few enough hours and to pay full SMI for six months after a claimant entered full-time work, as currently happens with the four week 'Mortgage Interest Run On'.[44] The advantage of this approach is simplicity. The disadvantage is that no effort is made to ensure level of entitlement reflects circumstances - someone with part time earnings, or someone in a new full-time job, would be receiving the same as someone in a workless household.

> **"At a time when we desperately want to see more people working and avoid high long-term unemployment, the last thing policy should be doing is penalising people for moving back into work on a part-time basis."**

   Another option would be to treat SMI payments as if they were part of Universal Credit entitlement when applying the UC taper rate. If they moved into work, claimants would see their SMI tapered away after other UC entitlement had been withdrawn. If they began working more than 16 hours a week but continued to be eligible for some UC, they would continue to receive SMI for six months, and if they increased their hours or earnings they would gradually move off support. This is effectively how the housing element of UC is treated for renters. As is the case with renters, the lower 'UC with housing costs' work allowance would apply. This would also mean that, if the claimant maintains employment for six months and SMI is withdrawn, an increased work allowance could offset some of the lost income. Unlike with renters, however, UC would still be the 'passporting benefit' and SMI would not be a full new element of UC. This would mean SMI would not expand UC entitlement up the income scale, but claimants who had previously been

44 Gov.uk, Mortgage Interest Run On. Link

receiving it and then began moving into work would benefit from tapering rather than a 'cliff edge'.

Another alternative approach would be a staggered withdrawal of support as a claimant earned more. For example, claimants working up to 16 hours could receive half the normal SMI entitlement. This would, effectively, mean two smaller cliff edges instead of the current single large cliff edge when a claimant takes on any work.

Again, a key criterion here is the ease with which these changes could be implemented. Given the likelihood of significant unemployment once the furlough scheme ends and the mortage holidays are withdrawn, it is better to have an imperfect system in place in timely fashion than no system at all.

6. **Make SMI time-limited for claimants who are able to work.**
   The Government should aim to create a generous but cost-neutral scheme that supports people when they need it most. However, where a household has got into difficulties it cannot escape from, prolonging this is not helpful to any side. Therefore, we would propose the period for which SMI can be claimed should be limited to two years for claimants in the 'intensive work search' group who are not in receipt of a disability-related benefit. This would mirror the two-year time limit which used to apply to SMI claimants in receipt of Jobseeker's Allowance but which was not carried over into Universal Credit or into the new loan-based system.

   When the household is less than six months away from termination of this support, the borrower should be notified of this in an attempt to make them consider their financial situation and whether or not selling the home might be the best way forward for them. This would reduce the risk of repossession and increase the chance of an orderly sale.

   These changes are long-term reforms and could be delayed until after the current crisis to avoid unnecessary complication.

We would argue that the current rules around the level of interest, and the cap of support in terms of only helping the first £200,000 of any mortgage, are broadly correct and would keep these as they currently are.

Taken together these changes would fundamentally make the SMI system more comprehensive while at the same time not adding to the burden on Government. They would also enable home owners to access the support they need – when they need it – without inflating prices or risking bad lending.

*Timeline of an SMI claim under current system and proposed reformed system*

| | Current system | Proposed reforms |
|---|---|---|
| **Day 1** | | Grant-based SMI becomes available |
| **3 months** | | SMI converts to interest-free loan |
| **6 months** | | |
| **9 months** | Interest-bearing SMI loan becomes available | |
| **12 months** | | |
| **15 months** | | |
| **18 months** | | |
| **21 months** | | |
| **24 months** | | Entitlement ends for claimants in the 'intensive work search' group, interest begins to accrue on SMI loan. |

## Conclusion; These reforms are both compassionate & cost saving

The pandemic has meant that millions of people across the UK face the prospect of either losing their jobs or experiencing severe shocks to their income.

In many cases this will be a temporary period of stress, as different parts of the economy either return to normal or adjust to the changed circumstances post-pandemic.

The Government has rightly focused on the need to use policy to bridge that gap, through schemes such as the Job Retention Scheme and temporary changes to welfare rules to support incomes. But the impact of this disruption to people's finances on their ability to pay the mortgage cannot be overlooked.

The mortgage holiday has been a welcome stop-gap but it has already been extended and further extension would not be sustainable, as it would mean saving up even larger debts for the future.

During the last crisis, the Government stepped in with changes to the SMI scheme which have subsequently been shown to have succeeded in preventing repossessions for many who were eventually able to return to work and pay their mortgage again. In hindsight, the changes introduced in 2009 can be seen as a sound investment by the Government (even with the grant-based system as it was then), in that many of those who benefited from the additional support might otherwise have had to move back into the rented sector and taken years to look at buying again.

Beyond the financial consideration, SMI is a scheme for people on very low incomes, many of whom face great hardship. In particular, those who lose their jobs through no fault of their own as a result of the current economic circumstances will face all of the worries associated with job loss and reduced income. Relatively small changes to SMI could make a big difference for these people in removing the extra trauma of worrying about how they will pay the mortgage and whether they might lose their home as well as their job.

Even for those who may not move into work and be able to pay their mortgage long-term, SMI can play a role in allowing breathing space for them to reappraise their circumstances and if necessary sell their homes to avoid the trauma and indignity of repossession. We urge the Government to study these reforms closely and urgently.

Centre for Policy Studies


57 Tufton Street, London, SW1P 3QL
September 2020
ISBN 978-1-910627-92-1