A joined-up approach to helping mortgage borrowers

by Colette Best, Building Societies Association

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1 Executive summary

1.1 Background

In late 2010, the BSA began a project to consider what long term safety nets were available to help those in danger of repossession and what could be put in place in the future.

This report follows two previous documents: Long Term Safety Nets to Protect Mortgage Borrowers (November 2010), which set out initial options; and Government, Industry and Professionals' Views on Support for Borrowers Facing Repayment Difficulties (January 2011) which sets out the thoughts of a variety of relevant organisations.

Consumers get into difficulty meeting their mortgage payments for a variety of reasons, but most often not because the loan was unaffordable in the first place. People generally get into arrears because of unexpected life events such as redundancy or illness.

The report sets out four main solutions which can work together to form a long term safety net to protect mortgage borrowers.

1.2 Insurance

Payment protection insurance (PPI) has become tarnished in the view of consumers. However, bought and sold correctly, insurance can play a big part towards preventing repossessions. The insurance market has largely learnt from its mistakes over PPI and is creating innovative products which offer protection for the consumer's lifestyle, rather than just their mortgage payments. The Competition Commission Order on PPI has created a number of barriers to the selling of PPI and the OFT should keep a watching brief on how this affects take-up. Government should actively encourage the take-up of insurance as a means of preventing repossessions.

1.3 Flexible tenure

The term 'flexible tenure' encompasses a number of ideas which might help those struggling to meet mortgage payments. The idea of shared equity, whereby the consumer can sell or buy back shares in their property and pay rent on those shares while continuing to pay a mortgage on the shares they own is a good idea. Further work needs to be done to assess the feasibility of extending this outside of social housing, in particular into who might be interested in buying shares and what vehicles might be used to do so.

1.4 Lender forbearance

Forbearance on behalf of mortgage lenders along with low interest rates has been credited with keeping repossessions relatively low during the recent recession. What has come under less scrutiny by the Government and media is what forbearance options are offered by second charge lenders and other creditors, utility companies, mobile phone providers etc. Consumers should be able to approach whichever creditors they need to in order to explain they are having repayment difficulties and be assured of a reasonable conversation about forbearance options.

1.5 Government schemes

A number of government schemes to help prevent repossessions have operated through the recession with differing levels of success. Government should focus their funding on Support for Mortgage Interest (SMI), but with some modifications. SMI should be payable to all loans secured against the property and those outside the limits of the current scheme, with payments to these consumers offered as a grant with a charge secured against the property. The state could then recoup the money paid either as repayments from the consumer or through the proceeds of the sale of the property.

1.6 Summary of recommendations

Recommendation 1: Government should pursue a drive to increase the take-up of insurance which would help to meet mortgage payments and the payments on other debts.

Recommendation 2: mortgage lenders, government and other stakeholders should undertake a feasibility study of which organisations might be disposed towards purchasing shares in consumers' properties and the vehicles which they could use to do so.

Recommendation 3: industry should keep a watching brief on the sale and rent back sector as regulation beds in to determine whether it can play a future role in the safety net. The FSA should publish statistics on a regular basis on the size and make-up of the sale and rent back market.

Recommendation 4: Government should consider options for different lengths of tenancy agreements in the private rented sector.

Recommendation 5: the forbearance options and process offered by unsecured lenders should be considered by government as part of the overall review of the regulation of consumer credit.

Recommendation 6: lenders should encourage borrowers to seek independent debt advice before offering forbearance and ensure that they have had a full opportunity to do so.

Recommendation 7: there should be increased sharing of information between first and second charge lenders before either begins repossession proceedings.

Recommendation 8: SMI should be reformed to extend its availability, pay interest at the rate paid to the lender and offer support for those accessing it long-term.

2.1 Introduction

Shelter is one of the basic human needs. In British society we have very strong ideas that the ideal form of shelter is owning your own home, or aspiring to do so. We have, over the past few years begun to see some demographic and attitudinal changes to the private rented sector and some years in the future this may begin to be seen as a more desirable tenure. But for the time being at least, the desire to be an owner-occupier is deeply routed in our nation's psyche.

For most people, this drive for property means taking on a mortgage. Generally, a mortgage is entered into when times are good, and sentiment in the economy is positive – for example there are few people who would seek to buy a house when going through a serious illness – so we sign our mortgage contracts with optimism. However, the realities of life mean that we are often beset by unexpected events which we would prefer to believe will not happen to us, and when they do, paying a mortgage is perhaps the least of our immediate worries. But the realities of life also mean that pay the mortgage we must, and finding ways to help people to do that is the subject of this report.

A recent report by the Financial Inclusion Centre (July 2011) found that the problem of meeting mortgage payments is more widespread than is often quoted in the media:

"we have analysed published FSA data and we estimate that of the 11.3 million outstanding mortgages, 1.2 million (11%) are in some form of distress – whether in arrears, already repossessed or subject to forbearance by lenders. This is much greater than the 2.5 - 3% of mortgages considered to be in arrears or repossessed that is widely quoted."

For people who find themselves in the situation of not being able to meet their mortgage payments, a mortgage safety net to help them out can make the difference between getting back on their feet and homelessness. Aside from emotional trauma of uprooting a family, research commissioned by the Department for Communities and Local Government, (A qualitative study of voluntary possession and selling because of financial difficulties, J. Ford et al, August 2010) suggests that the majority of people who have their property repossessed would not wish to buy a home again in the future. These lasting negative feelings towards homeownership will likely affect the rest of the lives of people whose homes have been repossessed. One participant in the research, stated:

"I will never buy again. I don't ever want to be in this mess again."

The bigger picture is that there are benefits of keeping people in their homes for society. Settled communities are productive ones and make good places to raise a family. Repossessed properties can often take time to sell and blight an area, dragging down property prices and attracting vandalism. We have seen instances in America of entire neighbourhoods filled with un-sellable properties which have been repossessed by banks and, whilst the housing market in the UK is faring much better than that of the USA, there is still the potential for localised pockets to be affected in this way.

Government has an interest in keeping people in their homes. There is often a financial cost of rehousing families whose homes have been repossessed where they are considered vulnerable and at risk of homelessness. Research shows that almost half of those who had their homes repossessed by lenders went into social housing as did just over a third who were voluntarily repossessed (Analysis of three-year Survey of English Housing data, Rhodes and Ford, 2010). Added to this, we are seeing an increased push to measure and make political decisions based on societal well-being as well as GDP. In a speech about the proposed National Wellbeing Index, the Prime Minister David Cameron said:

"Of course you can't legislate for fulfillment or satisfaction, but I do believe government has the power to improve wellbeing. To those who say that all this sounds like a distraction from the serious business of government, I say finding out what will really improve lives and acting on it is the serious business of government."

There are observable links between repossessions and a decline in physical and mental wellbeing, measured in GP visits and self-assessment wellbeing scales. Reducing the risk of being repossessed is a clear way of increasing wellbeing. The knowledge that safety nets are in place is a good way to improve sentiment in the housing market. The majority of housing transactions are discretionary; ie people move because they want to, for a number of reasons such as wanting more space, rather than out of necessity, such as moving for work. We are currently seeing a stagnating housing market, with historically low levels of property transactions, caused in part by a lack of confidence in the economy. A safety net to help mortgage borrowers stay in their homes in times of difficulty would go some way to encourage those discretionary house buyers back into the market. First time buyers in particular, who may not remember previous recessions, have been disproportionately affected by the economic slowdown through not being able to access mortgages and some of the measures may be helpful in encouraging them into the market and seeing them through to the next economic cycle.

For lenders too, preventing repossessions is likely to make business sense. Both the process and the outcome of repossession is costly and the reputational hit which lenders take for repossessing properties is difficult to quantify. Regulation surrounding taking possession of a property is so tight that it is by no means the easy or cheap option. The length of the sales process can mean that borrowers get into further arrears and in a falling market the property can lose value in the interim period. The desire of the lender and borrower to sell a property quickly, as well as the problems with selling an empty property, can mean that the market values repossessed homes lower than the open market value and lenders can suffer a considerable loss where prices are not achieved.

So that is the 'why' of preventing repossessions, but the 'how', as ever, is somewhat more difficult. That is what this report seeks to address.

2.2 Process

In late 2010, the Building Societies Association (BSA), began a piece of work to examine long term safety nets to protect mortgage borrowers. A report of the same name was commissioned by the BSA and written by John Howard, former presenter of 'You and Yours' on Radio 4 and former chair of the Financial Services Consumer Panel.

Long Term Safety Nets to Protect Mortgage Borrowers [the report] set out the extent and design of the existing safety nets available to mortgage borrowers and looked at what schemes and measures should be put in place going forwards. The initial report can be found at ***www.bsa.org.uk/docs/LTSNs.pdf***.

The report was launched at an industry breakfast meeting, which was attended by representatives from lenders, advice agencies, insurers, government and consumer groups. The participants recognised the need for private and public sector solutions to work together and pledged their support for the work.

Following the launch of the report, a variety of relevant organisations submitted their opinions on the extent of the problem and what might be done in the future. The submissions were collated into a document entitled Government, Industry and Professionals' Views on Support for Borrowers Facing Repayment Difficulties, which was published in January 2011. The document can be found at ***www.bsa.org.uk/docs/LTSNs_industryresponses.pdf***.

Keen to capitalise on the enthusiasm and goodwill generated by the report, the BSA set up a working group and hosted a number of themed meetings surrounding each of the solutions proposed in the report. The contents of this document are thanks in no small part to the contributions of those who attended the working group meetings, and I extend my thanks to all attendees.

This report brings together the views of a number of different people and is intended to provoke discussion and challenge traditional thinking. As such, it does not form official BSA policy but we hope that it will drive change towards a sustainable framework for preventing repossessions.

2.3 What causes repossessions?

In order to help those at risk of having their home repossessed, it is helpful to consider how the problem arises in the first place.

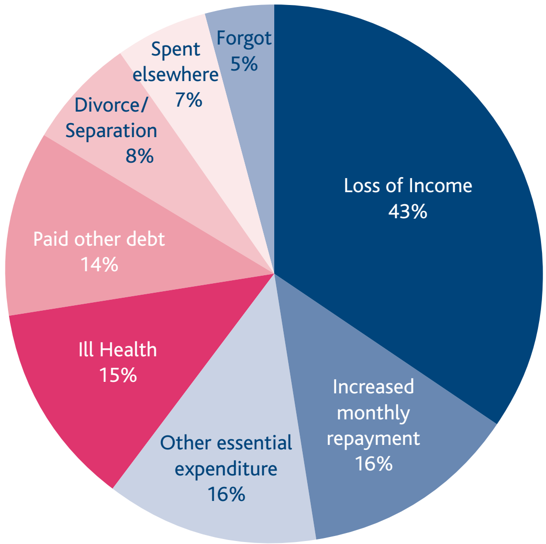
Getting into difficulty

Research by the BSA (Understanding Mortgage Arrears, A. Gall, 2009) showed that there was no particular demographic to borrowers getting into mortgage arrears. Instead, borrowers were beset by unexpected life events which caused them to get behind on mortgage payments.

The most common reasons for being unable to meet mortgage payments were a loss in family income (43%), increased monthly payments (16%), other essential expenditure (16%), ill health (16%) or paying other debts (14%).

Chart 1: Factors causing mortgage arrears

451 respondents who had missed two or more mortgage payments in the previous two years.



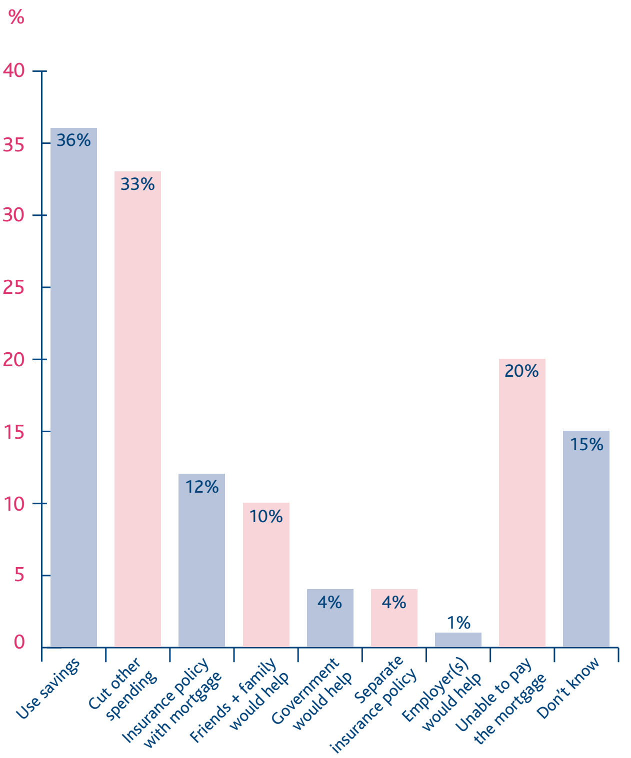
Respondents could choose more than one response, so percentages add to more than 100%

Source: Understanding Mortgage Arrears, A. Gall June 2009

In June 2011, we added an additional question on making mortgage payments in times of financial difficulty to the BSA Property Tracker, the quarterly consumer survey conducted on behalf of the BSA which gains insight into sentiment about the housing market. Property Tracker respondents were asked 'how would you pay the mortgage if your household lost its main source of income for an extended period?' The results backed up the assumption that most people who lost a portion of their family's income would either be unable to pay their mortgage or would be able to meet payments for a short time only. A quarter of people would be unable to pay their mortgage or didn't know how they would pay their mortgage if they lost a source of income. A little over a third of people stated that they would use their savings, which given the tendency for only small levels of savings to be held by households in the UK, is unlikely to be a realistic solution for more than a few months. Just 16% of respondents were protected by an insurance policy (either taken out with, or separate to the mortgage) which would help them pay their mortgage.

Chart 2: Meeting mortgage payments in times of financial difficulty

How would you pay the mortgage if your household lost its main source of income for an extended period?

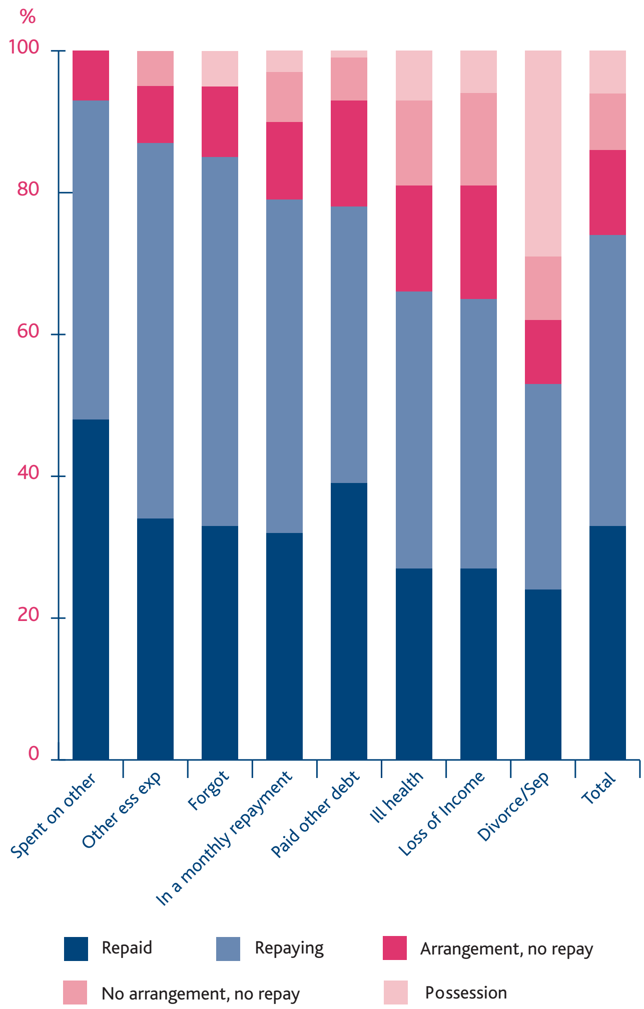


Excludes respondents who do not have a mortgage. Respondents could select more than one answer (unless they chose 'unable to pay mortgage' or 'don't know') therefore the results do not sum to 100%

Number of respondents: 1,155
Source: BSA Property Tracker, June 2011

Chart 3: Repayment by cause of arrears

451 respondents who had missed two or more mortgage payments in the previous two years.



Source: Understanding Mortgage Arrears, A. Gall June 2009.

From arrears to repossession

The BSA research Understanding Mortgage Arrears looked at what happened to those households who had gone into mortgage arrears. The majority of people had either repaid their arrears (33%) or were in the process of repaying their arrears (41%). There was a correlation between the cause of the mortgage arrears and whether they would be able to repay them. Arrears caused by divorce or separation were the most likely to be possessed by the lender (18%), with 4% of ill health and loss of income arrears ending in repossession. On average 3% of arrears cases were repossessed by the lender.

3.1 Possible solutions

This document builds upon the four possible solutions identified in the initial report. The solutions identified were insurance; flexible tenure; forbearance; and government schemes. None of the options taken on their own are likely to provide a universal safety net. Instead, we see the solutions working together to form a framework which can provide a suitable option for each individual or family.

3.2 Insurance

Insuring against being unable to make mortgage payments is seemingly the simplest way to prevent repossessions. In the 1990s, the take up of Mortgage Payment Protection Insurance (MPPI) was actively encouraged by lenders and government as part of a strategy to protect the 'average mortgage borrower', the profile of which was changing rapidly. The support for MPPI also came about as a result of the reduction in state provisions for those struggling to meet mortgage payments, which necessitated a private sector solution to fill this gap. Despite the emphasis placed on MPPI, take-up of products remained relatively low. Encouraging consumers to make provision for the eventuality that they are unable to meet their mortgage payments would be a good starting point for preventing repossessions.

If everyone had MPPI then the Government schemes and other initiatives would become largely obsolete and the greater number of people taking out the insurance would mean that the average price of insurance would come down. So to take this to its logical conclusion, should everyone with a mortgage also be required to have insurance against being unable to pay it? A legal requirement for all borrowers to have insurance has been largely ruled out by government as it would be perceived as a tax on mortgages. There would also be people who would find it difficult to get insurance cover, for example those who are self-employed or those with existing health conditions. Instead of seeking blanket MPPI for everyone, we should be focused on increasing the number of people with cover. The two main barriers to increasing the take-up of insurance are described below: the Competition Commission Order restricting the selling of MPPI; and the general public's perception of the products.

Over the past few years payment protection insurance (PPI) in general has been the subject of lengthy debates by regulators, the courts and the media and we are now left with a product which is held in low regard by the general public. The OFT asserts that there has been considerable consumer detriment arising from the selling of PPI as well as the underwriting at the point of claim which has left numerous people unable to claim from a product on which they have sometimes spent considerable amounts of money. Mortgage payment protection insurance has been drawn into the fray somewhat less fairly, as it has not attracted the same level of complaints resulting from PPI. In its consideration of a super-complaint made by Citizens Advice, the OFT market study on PPI noted that there were more standalone providers of MPPI than PPI and that the point of sale advantage is weaker. Despite this, the OFT chose to include MPPI within its consideration, which meant that it was included within the Competition Commission Market Order which will place certain restrictions on the selling and administering of such products. Under the terms of the Order, firms must not sell any form of PPI at the same time as arranging a mortgage until after seven days have elapsed. This seven-day period is intended to ensure that customers are not pressurised into purchasing PPI and have time to shop around for alternative products. However, this places a very real barrier in the way of increasing the take up of insurance to prevent repossessions as consumers who don't buy an insurance product alongside the mortgage are much less likely to take out a policy. The Competition Commission Order placing restrictions on the selling of PPI has been the subject of much discussion throughout the course of this work, and elsewhere. To address the concerns of the OFT and Competition Commission, MPPI needs to become easier to understand, more transparent and portable.

For consumers to view MPPI as a useful product, it does need a number of changes and these are beginning to take place as the protection market evolves. We are seeing a shift from MPPI, which solely covers mortgage payments in the event that the individual suffers an unexpected event, to 'lifestyle cover'. This type of 'income insurance' will not just meet mortgage payments, but will pay a monthly sum to allow the consumer to meet essential outgoings. The shift to a lifestyle alternative provides a better product for the consumer as they would be able to use the cover to meet other payments, for example those on credit cards. The policies also tend to be underwritten at the point of application, rather than upon claim, meaning that they have a better record of paying.

The market is working to create innovative products and we welcome the increase in consumer choice in this area. For example, one new product, along with making a financial payment, will provide assistance to the claimant to help them get back to work if they have lost their job. The shift to whole lifestyle cover tackles the bigger issue of repossession and would also assist those in the private rented sector.

Is there a role for government in increasing the take-up of insurance? As previously stated, a blanket requirement for all mortgage borrowers to take out MPPI has been ruled out by government, but this doesn't mean that the take-up of insurance can't be encouraged in other ways. A new and transparent income insurance product should be considered as part of HM Treasury's work on simple financial products. The initiative on simple products led by the Treasury would be an excellent vehicle for creating a product which would be trusted by consumers and which would have fair and reasonable underwriting criteria. Products should be easily comparable by consumers in terms of price and cover provided. A simple product should still provide value for money to consumers, although we should seek to prevent over-commoditisation and a race to the bottom on price. Income protection should be affordable, but this must be balanced with creating a product which provides value and does not have excessive conditions and exclusions.

Government and industry should continue to petition the Competition Commission for mortgage payment protection insurance to be treated differently from other types of PPI. This is obviously a long-term solution, however the removal of some of the restrictions could mean that lenders could encourage consumers to take out insurance when they are having a conversation with them about their mortgage. We would especially encourage the OFT to keep a watching brief on the take-up rates of protection insurance once the Competition Commission Order comes into force and consider revoking it, should there be evidence that it is significantly and adversely affecting the take up of protection insurance.

Should government wish to indicate its commitment to increasing the take-up of insurance, they could consider offering tax breaks on insurance premiums and should ensure the existence of a policy means that they are not adversely affected by the welfare system.

The savings to the state of a greater take-up of lifestyle insurance could be considerable and a cost-benefit analysis should be undertaken to determine the extent to which it would pay to offer tax incentives on premiums.

> **Recommendation 1:** Government should pursue a drive to increase the take-up of insurance which would help to meet mortgage payments and the payments on other debts.

Another option is for lenders to insure themselves against borrowers being unable to meet their mortgage payments. A lender could take out a block policy which would pay out to the lender if the borrower was unable to pay their mortgage and would allow them to offer forbearance without incurring loses. This could be a good option, although it may add cost to the price of the mortgage potentially meaning that the lender would be uncompetitive in the market. Despite this, the cost to the consumer of taking out both a mortgage and insurance in this way could be lower than purchasing both separately. There are several barriers to this approach, such as the criteria insurers might impose on lending policy, the difficulty in obtaining cover for self employed borrowers and the lack of mainstream cover for arrears arising out of a relationship break-up. Lenders might consider whether they can absorb the cost of MPPI themselves and balance this against the losses they make on arrears and possessions, subject to the potential barriers raised above.

Some people may wish to self insure against the possibility of being unable to pay their mortgage, essentially by building up a pot of savings which they intend to use to make payments should they need to. The problem with this is that the majority of people in the UK have low levels of savings and there is a danger that they could be put to other uses than meeting mortgage payments. Lenders could consider offering savings products so that the borrower has a specific pot of money which can be used in the event that they get into mortgage arrears. The savings would be able to be accessed by borrowers for other purposes, but with penalties for making withdrawals. Lenders could offer borrowers the option of interest to be paid on their savings, or for them to be offset against their mortgage.

Consumer bodies have a part to pay in encouraging the take-up of insurance. Unbiased advice to consumers will play a huge part in rehabilitating insurance products and providing assurance to consumers that there is value to having a product which meets their needs. Proactive advice to consumers on managing their finances should include a discussion of whether or not insurance might be appropriate for them. This advice, while not seeking to use shock tactics, should seek to make consumers aware of the limits of government schemes and the realities of whether they could use savings to meet mortgage payments and other outgoings.

3.3 Flexible Tenure

The housing market is very illiquid; properties are bought and sold relatively infrequently, selling is a lengthy process and the value is often not readily determinable. These characteristics of the housing market make it difficult for those getting into difficulties meeting mortgage payments to quickly and efficiently exit home ownership.

Flexible tenure is a rather broad term which encompasses a number of proposed solutions in the initial report. In general though, we use flexible tenure to denote an alternative to ‘full’ home ownership, ranging from shared ownership to selling the property through a sale and rent back agreement.

Shared ownership schemes are reasonably well established in the UK but are generally available only upon entering home ownership. They allow consumers to buy a ‘share’ in their home with the remainder being owned by another organisation, typically a housing association to which the consumer pays rent. Shared ownership agreements generally allow the owner to increase the share of the property that they own over time. Some agreements allow the owner to decrease their share, although this is less common.

Shared ownership is particularly useful for first time buyers wishing to take the first step onto the housing ladder as it reduces the amount of deposit and mortgage required and lessens the effect of falling house prices. But there are benefits to those in the wider housing market and not just first time buyers, mainly due to subsidised rents the overall monthly costs tend to be lower than owning outright.

Shared ownership schemes could play a part in keeping home owners in their homes if we could devise a way of allowing home owners to vary the share of their property which they own. This might mean that someone struggling to meet mortgage payments would sell off some of the equity in their property to a third party and pay rent on this part while continuing to live in the property. Then, at such point when their circumstances improve, they could buy back the shares in their property and own it outright again, or if their circumstances do not improve, sell their remaining shares in the property and become a renter. This ability to 'staircase' up or down would help make the property assets more liquid and could be adapted to each individual's circumstances.

There are three main barriers to this model: firstly whether the monthly costs of paying part mortgage part rent would be less than meeting the entirety of mortgage payments; secondly which organisations would be willing to purchase the equity in a property; and thirdly the costs of staircasing including valuers fees, conveyancing and ensuring that the consumer is sufficiently well advised to allow them to make an informed decision.

At time of writing we are seeing an upward pressure being put on the private rented sector with rental yields and the amount of rent being charged at a historical high. The latest RICS Residential Lettings Survey published in April 2011 showed that rents continued to grow and noted that "supply constraints and strong tenant demand are pushing rents higher". At the same time as increasing rents, we have historically low interest rates, meaning many mortgage payments are low. So in order for the total costs to the homeowner to be lowered the amount of rent charged would likely need to be at a level below that which would be payable on the open market which might suggest that the organisation charging rent would need to be a social housing provider, or to have some degree of government subsidy. However, a similar level of rental and mortgage monthly payment does not necessarily rule this option out. It may be useful for those who have acquired high levels of debts in addition to their mortgage (for example through credit card spending) and need a lump sum to pay them off, thus reducing the monthly payments and allowing them to direct their disposable income towards housing expenses.

The second barrier of identifying an organisation which is willing to purchase shares in people's homes, given a diverse geographical spread and with a mixture of housing types is complex. A number of members of the themed meetings held by the BSA suggested that lenders could become involved with shared ownership, seeing as they already have an interest in the property. We have broadly discounted this idea as building societies and banks would be unable to deal with rent or mortgage arrears if they were both the mortgagor and landlord and this dual role is likely to cause significant conflicts for the lender. Additionally, the levels of capital that mutual lenders would be required to hold in order to become a landlord this way would be prohibitive.

An open market solution is needed and for this there needs to be better information on shares available and those willing and able to buy them. One possibility is that the purchase of shares in people's property could form part of an investment portfolio, be included within an ISA or become part of a pension fund. The extra levels of regulation and controls which would be needed to make such an idea work would add considerable cost to the process, however it is one worth evaluating fully.

We therefore recommend that the lending community, government, housing associations and other interested parties should undertake a feasibility study of which organisations might be disposed towards purchasing shares in consumers' properties and the vehicles which they could use to do so.

Recommendation 2: mortgage lenders, government and other stakeholders should undertake a feasibility study of which organisations might be disposed towards purchasing shares in consumers' properties and the vehicles which they could use to do so.

At the far end of the staircasing idea is the possibility for home-owners to sell their property and remain in it as a renter. At the height of the property boom, a number of companies sprung up offering to buy properties and rent them back to their former owners. These 'sale and rent back' agreements were marketed to those experiencing severe financial difficulties and played upon people's desire not to leave their home or have neighbours be aware of their problems. For some, sale and rent back provided a good short-term solution, but for a number of people the unregulated sector caused significant consumer detriment.

In 2008, an OFT market study examined the sale and rent back model and decided that there were grounds to believe the market wasn't functioning well and concluded that the sector should be regulated. The FSA swiftly put in place an interim regulatory regime and a full regulatory regime came into force on 30 June 2010. There are still a number of loopholes to be closed as the regime applies only to those firms offering sale and rent back 'by way of business', a distinction which has been exploited by some firms. The process to introduce secondary legislation to close this loophole is underway and an announcement is expected later in the year as to when this will take place.

At the heart of the OFT's concerns over sale and rent back was the information provided to potential customers. Under the new regulatory structure, firms are required to disclose details of the transactions in a fact sheet and provide an open market valuation by a valuer who has a duty of care to the consumer. These requirements have improved the standards of care by sale and rent back providers but agreements should still be looked at with extreme caution.

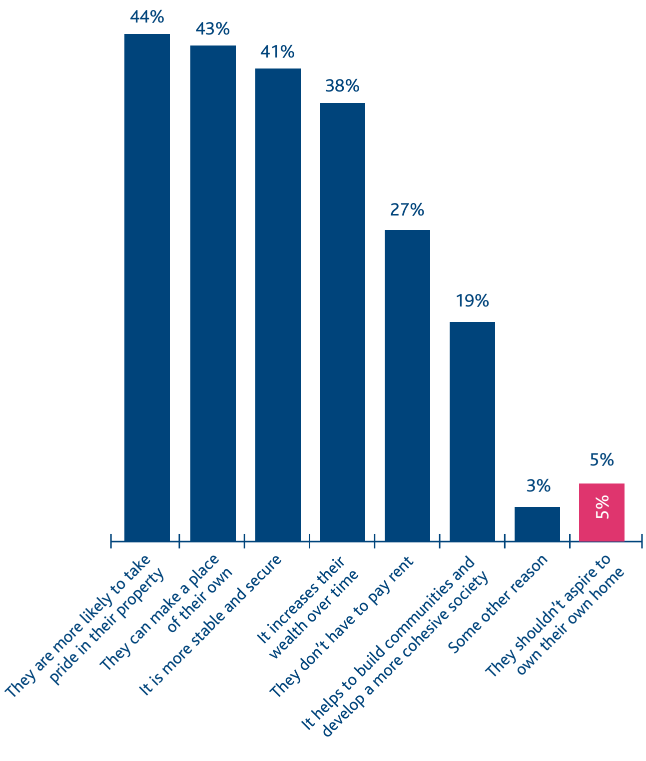
In light of the above, the sale and rent back industry is currently too small, and regulation too recent for it to play a major role in the safety net to protect mortgage borrowers at present. The industry is showing an increased willingness to improve its standing and may be in a position to help more borrowers when regulation has further bedded in.

> **Recommendation 3:** industry should keep a watching brief on the sale and rent back sector as regulation beds in to determine whether it can play a future role in the safety net. The FSA should publish statistics on a regular basis on the size and make-up of the sale and rent back market.

In a number of the discussions surrounding flexible tenure, the question of why people choose to buy in the first place came up. It would be remiss to consider the reasons that people get into difficulties in paying their mortgage without considering why people choose to buy in the first place. Despite recent press coverage that we are increasingly viewing the private rented sector more favourably, home ownership is still seen as the tenure of choice and the vast majority of those who see renting as the norm currently still aspire ultimately to own their own home.

In the March 2011 BSA Property Tracker, respondents were asked why people should choose to own their own home. There was no one clear motivation for owner-occupation, but what was striking was that only 5% of people thought that 'they shouldn't aspire to own their own home'.

Chart 4: Why should people in the UK aspire to own their own home?



Sample size: 2,026. Respondents could choose more than one option.

A large number of respondents (41%) thought that people should aspire to own their own home because it 'is more stable and secure' and this goes to the heart of why we have such a love of property ownership in the UK. Feeling secure in your home is an important psychological motivator for buying and this reflects the instability of renting. On the continent, the housing market is characterised by a greater proportion of people living in rented accommodation, staying in the same rented property for longer and experiencing greater security of tenure than in the UK. According to the 2011 RICS European Housing Review, 53% of people in the Netherlands are homeowners and in France 57% are owner-occupiers. In Germany, there are large regional variations in home ownership, but in Berlin 90% of the housing stock is rented (J, Palmer "Brits buy homes, the Germans rent", published in the Guardian 19 March 2011). Rents are tightly controlled and consumers can check if rent is fair using their city's rental index. Unlimited contracts are standard and tenants rent for the long term.

In some European rental markets, the longer the length of tenancy, the longer the period of notice is needed by either the tenant or the landlord to end it. Such scalable periods of notice could be useful in the UK market where some consumers will want the flexibility to move frequently, whereas others will prefer long-term stability. Tenants' rights must be balanced with responsibilities, but alternatives to the Assured Shorthold Tenancy (AST) agreement which is used as standard in the rental market should be considered. Given that the private rented sector is becoming such a vital tenure for the UK population and economy, changes should not be made without assessing their impact on the supply of properties and buy to let finance for the sector.

If UK consumers were to have the option of longer tenancies, we might see fewer people over-extending themselves to get into home ownership. A better private rented sector might mean less home ownership, or it might mean that we enter into home ownership at a more appropriate time, later in life, but either way there should be a more secure alternative to owner-occupation. Greater professionalism and regulation of the private rented sector was suggested in The Rugg Review published in 2008, but the recommendations were not acted upon by government.

The UK housing market should provide attainable and sustainable choices in tenure to those at various life stages, comprising a mixture of high quality rental properties; homes of various sizes and conditions for sale; and social housing. Rather than being fixated about getting onto the housing ladder as soon as possible it is right that we aspire to the right tenure at the right time in our lives at the right price.

Recommendation 4: Government should consider options for different lengths of tenancy agreements in the private rented sector.

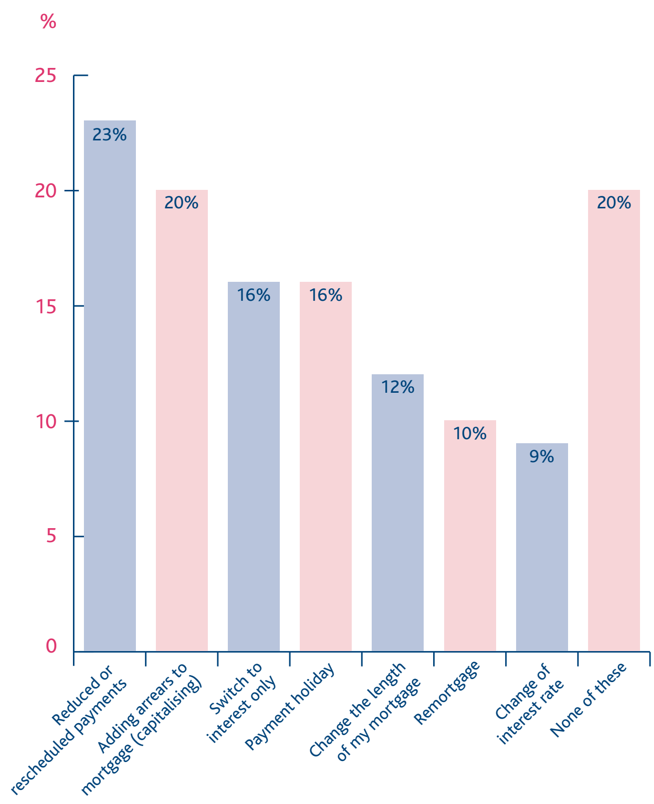
3.4 Forbearance

Forbearance is a wide topic, which covers a variety of ways in which mortgage lenders can help borrowers struggling to meet mortgage payments. However, often mortgage payments are only part of the problem and therefore the lender can only be part of the solution.

Lenders have a number of options to help borrowers who are having difficulties meeting payments. The BSA's Understanding Mortgage Arrears research showed that the most common were reducing or rescheduling payments; adding arrears to the mortgage balance; switching the borrower to interest only payments; offering a payment holiday; and changing the length of the mortgage.

Chart 5: Loan modifications offered to borrowers in arrears.

451 respondents who had missed more than one mortgage payments over the previous two years.



Borrowers could select more than one, so percentages do not add to 100%

Source: Understanding Mortgage Arrears, A. Gall June 2009.

Lenders must be careful to balance the short-term needs with the long-term interests of the customer. A measure that helps the customer to meet their mortgage payments over the first few months of getting into difficulties might mean that they incur more debt in the long-term and if their situation becomes untenable, ultimately increases the total amount owed. Clearly this is not in the borrower's nor the lender's best interests. Deciding at the outset whether a customer is likely to get back on their feet and resume payments is almost impossible to determine and lenders run the risk that deciding that a customer is unlikely to be able to start meeting payments again will become a self-fulfilling prophecy. But these are the very real, and very difficult judgement calls that lenders must make.

The regulation surrounding the provision of forbearance is lengthy and strict. The FSA Handbook and Mortgage and Home Finance: Conduct of Business Sourcebook governs how forbearance can be offered and the Civil Justice Council's Pre-Action Protocol ensures that lenders must take certain steps before beginning repossession proceedings. These prescriptive rules and regulation have meant that lenders can lack the freedom to act in the customer's best long and medium-term interests. The recent consultation by the FSA into Forbearance and Impairment Provisioning puts further constraints on how lenders may offer forbearance. The emphasis of the guidance is offering workable short-term solutions to help consumers who can get back on their feet quickly but not offering indefinite forbearance to those which lenders feel will not be able to resume making mortgage payments. The FSA have stated that they will be following up upon the guidance as part of their "intrusive and intensive supervisory approach".

A key problem is that payments due on unsecured lending, mobile phone bills, utility bills etc cannot be addressed through forbearance by mortgage lenders. Often, the mortgage payment itself is affordable for the consumer, but the weight of other unsecured loans means that their debt as a whole is unmanageable. There is a role for advice agencies to play in helping customers deal with the entirety of their debt, rather than being reliant on the mortgage lender to assist with a small part of it. We have seen through the recession that forbearance by mortgage lenders has played a valuable part in keeping repossessions to a minimum, however it is now time for other creditors to play an increased part in offering forbearance on debts owed to them.

There has been a considerable amount of press coverage and consumer advice during the recession which urged those getting into payment difficulties to get in touch with their building society or bank and come to an arrangement on paying their mortgage – and rightly so. What this has meant though, is that consumers are very focused on making forbearance arrangements with their mortgage lender and can overlook doing the same with other creditors.

Consumers should be encouraged to contact other creditors: mobile phone providers; credit card companies; and other unsecured loan providers, to make altered payment arrangements with them or to cancel payment arrangements. Creditors should be amenable to such discussions.

Unsecured lenders recover debts in a considerably different manner to mortgage lenders, mainly due to the fact that there is a different regulatory structure in place. The different requirements surrounding forbearance have emerged for historical reasons, but there is no strong case that there should be separate structures in place, particularly when the monthly payments on unsecured credit can exceed that owed on secured. For these reasons the forbearance options and process offered by unsecured lenders should be considered by government as part of the overall review of consumer credit regulation. If the regulation of consumer credit is transferred to the Financial Conduct Authority (FCA), then the complete life-cycle of a loan will be reviewed. The FCA may choose to align practices and procedures which could lead to changes for secured and unsecured lenders alike.

There have been a number of positive industry-led initiatives which have increased the standards of those who signed up to them. An example of one such initiative is the Lending Code sponsored by the Building Societies Association, British Bankers' Association and UK Cards Association which covers personal loans, credit cards and current account overdrafts. The code requires lenders to act sympathetically and positively when considering a borrower's financial difficulties and to consider stopping asking for repayments for 30 days in order for them to get advice or present a payment plan. The Finance and Leasing Association produce a separate document also called The Lending Code which covers store and credit cards, personal loans and motor loans taken out with their members. The Code includes requirements on dealing with consumers in financial difficulty.

Such codes are extremely positive steps, but their voluntary nature mean that it is those companies which have high standards and generally deal sympathetically with customers in difficulty which will sign up to them. The self selecting natures of the codes mean that there is not a level playing field between organisations which operate under strict standards and those who choose not to.

Recommendation 5: the forbearance options and process offered by unsecured lenders should be considered by government as part of the overall review of the regulation of consumer credit.

The interaction between servicing secured and unsecured debt is a key part of preventing repossessions. Having problems meeting mortgage payments might be the trigger which prompts consumers to seek financial or debt advice. It is important that the consumer's whole problem is examined when giving debt advice, not just the symptom of being unable to pay the mortgage. Lenders have had the role of debt advisor thrust upon them as part of the forbearance requirements, and many are unqualified to provide assistance which tackles the whole of the issue.

Lenders should ensure that they have links with debt advisory agencies, who can act independently to advise a consumer of their options for dealing with debt and help them to plan for the future. It is essential though, that in tackling debt issues, the advice agency looks at the problem in its entirety and considers unsecured as well as secured loans.

Recommendation 6: lenders should encourage borrowers to seek independent debt advice before offering forbearance and ensure that they have had a full opportunity to do so.

A second charge mortgage is a loan secured on a home, when it is already acting as security for an existing mortgage. Second charge loans have been used extensively for debt consolidation and also as a cheaper alternative to unsecured loans. Despite the similarities between first and second charge loans, they are regulated by separate bodies: first charge by the FSA, and second charge by the OFT. Due to this disparity of regulators, separate regulatory regimes are in place. The OFT updated its irresponsible lending guidance for creditors in February 2011, however the guidance is not the strict rule-based approached adopted by the FSA for first charge lenders, but is instead used "*to inform creditors of those behaviours that are likely to cause the OFT to consider fitness to hold a credit licence rather than to identify practices which, if conducted in isolation, might call into question the validity of individual agreements.*"

There are currently around 450,000 second charge mortgages in the UK, according to HM Treasury's impact assessment dealing with how the sector should be regulated. As a result of the Government's drive to enhance consumer protection in the mortgage market, the regulation of second charge mortgages should move to the FSA (or the successor agency, the FCA), however the issue has become enmeshed with that of wider transfer of consumer credit which will not happen until 2014 at the earliest. In the meantime, the lack of coordination between first and second charge lenders is causing consumer detriment, in particular when one party seeks to take possession of the property. A first charge lender may be unaware that repossession proceedings have started by a second charge lender or vice versa until the property has actually been sold and is therefore unable to support the consumer. Second charge lenders should therefore be required by their regulator to inform a first charge lender when they begin possession proceedings, and first charge lenders to inform second charge lenders if they are aware of the existence of the loan. The lenders can then work with the borrower to assess whether the situation is recoverable and possibly offer forbearance on the loans if there is a reasonable chance of them getting back on their feet. The BSA, FLA and CML have worked together to produce a questionnaire which would allow such information to be exchanged.

Recommendation 7: there should be increased sharing of information between first and second charge lenders before either begins repossession proceedings.

Lenders should always seek to exhaust all options to keep a borrower in their home, up until the point where this is no longer in the consumer's best interests. When lenders have reached the point where forbearance has been exhausted, they can still have a number of options to help the consumer. Although a little outside the scope of this report, lenders should consider mechanisms to ease borrowers' transition from home ownership. Assisted voluntary sale is a mechanism through which borrowers and lenders work together to sell the property and achieve the best outcomes in terms of sale conditions for both parties. It is difficult to standardise this process, as the individual circumstances of borrowers, as well as the resources of the lender, will vary considerably. In these cases lenders should do what they can to help borrowers exit home ownership and should share information with local authorities, where appropriate, to help the transition to social housing.

3.5 Government schemes

Repossession has a direct financial impact on the state. The recent HMT impact assessment on regulation of the second charge mortgage market stated that:

"over a third of those who lose their homes will go on to need support from government, for example social housing or housing benefits".

There are several government schemes to help mortgage borrowers, which have operated with varying levels of success throughout the recession.

Homeowner Mortgage Support (HMS) was a scheme launched in April 2009, but closed two years later in April 2011. It allowed homeowners to defer paying 70% of their mortgage interest for up to two years, most of which was covered by a guarantee by the Government to the lender if the borrower were to default and the lender suffered losses. The borrower paid the remaining 30% of the interest monthly. The scheme helped a limited number of people and was criticised by lenders for being complicated to access and difficult to administer.

The Mortgage Rescue Scheme (MRS) was launched in England in January 2009 and provides several options to consumers. Subject to meeting the scheme's criteria, they could either sell a portion of the equity in their home and pay rent on that portion to their local authority, or sell their home outright to a registered social landlord and remain in it as tenants paying rent at an affordable level.

The National Audit office recently reviewed MRS in England and found that despite being expected to help 6,000 households and to cost £205m, it actually helped 2,600 households and cost £240m. This was largely due to more people than expected wishing to exit from home ownership completely and sell their property to a registered social landlord.

The English scheme will close to new entrants in 2013 and until this point it will be managed by the Homes and Communities Agency (HCA) which will also allocate the funding for the scheme meaning that the role of central government will cease.

Funding for those currently using the scheme will be wound down from 2013, meaning that more people may need assistance through other schemes. However, given the ineffectiveness of the scheme and the large cost at which it operated, diverting government money to other more efficient schemes is appropriate.

The Support for Mortgage Interest scheme (SMI) makes payments towards a mortgage for those in receipt of certain benefits (Income Support, income based Job Seekers Allowance, or income related Employment and Support Allowance). SMI has generally been deemed a success and the Department for Work and Pensions predicted that 200,000 individuals would benefit from it in 2011.

Given the number of people that SMI has helped, the scheme should remain in place but there is room for improvement. The scheme should be overhauled to make it more efficient and to allow it to help more people in need. At present, SMI only helps those who have suffered a complete loss of income. We have seen a great deal of people who have suffered a partial loss of income during the recession who have not been able to seek help from SMI. To reduce repossessions, SMI should be available to those who have suffered a partial loss in income and as a result are unable to meet their mortgage payments.

In order to help those affected by the recession, in January 2009 changes were made to SMI to make it accessible for more people. The waiting period before households could access SMI was reduced from 39 to13 weeks and the capital limit up to which interest could be met was increased from £100,000 to £200,000. These changes are currently intended to remain until January 2013. For the majority of people, waiting 39 weeks to be able to access a scheme is far too long, and for this reason the Government should retain the decreased waiting period as well as the increased limit on capital on a permanent basis.

The scheme pays a fixed rate of interest to all beneficiaries, regardless of the actual level of interest which is due on the mortgage. On 1 October 2010, the rate at which interest is paid was amended to 3.63% from 6.08% to reflect the change in the Bank of England base rate, and will change when the base rate differs 0.5% or more from the current rate. The fixed rate of SMI which is paid leads to some households receiving overpayments on their mortgage (although this is less often the case since the rate of interest paid was reduced), and others who see a shortfall in the interest payable. This is clearly an inefficient use of funds, so going forwards SMI should be paid at the rate due under the individual terms of the mortgage.

Another issue with SMI is that it applies only to the mortgage used to purchase the property, whereas we are increasingly seeing other debts being secured against the property. It is a futile exercise to pay the interest due on the first charge mortgage if the homeowner cannot meet the payments to other secured debts and the home is repossessed by a second charge lender. SMI should therefore apply to all loans secured on the property, regardless of the type of loan. With the funds made available from the closure of MRS and HMS, the remit of SMI should be expanded so that it is de-linked from employment benefits and made available to more people in need of the scheme.

Those outside the limits of the current scheme and those who have loans other than a mortgage secured on their property should have SMI paid as a grant, which would be repayable when their circumstances improve. To ensure the grant is repaid, a second charge would be secured by government against the property. The extension of SMI should be implemented on a sliding scale so that those just outside the current limits would pay back a lesser proportion of the grant than those deemed further outside the limits.

Detractors from this approach cite the possibility that mortgage lenders could lend irresponsibly safe in the knowledge that there is an explicit state guarantee which will pay the consumer's mortgage should they get into difficulty. However, the regulatory pressure on lenders to lend responsibly should ensure that this would not be the case.

The schemes made available by government have focused largely on dealing with the symptoms of repossession, and whilst this has been a reasonable approach during the recession, consideration must be given to assisting those receiving SMI in the medium to long-term. Government should identify those receiving SMI for a long period of time and work with lenders and advice agencies to provide support on managing debts, re-entering employment, or if the situation has become irretrievable, selling the property and either downsizing or entering the private rented sector.

Recommendation 8: SMI should be reformed to extend its availability, pay interest at the rate paid to the lender and offer support for those accessing it long-term.

4. Conclusion

Throughout the course of this work it has become clear that there is no silver bullet to prevent repossessions and so a number of private and public sector schemes must work in partnership. What has become apparent though, is the willingness for organisations and businesses to work together to help home-owners get back on their feet.

A number of themes have come up repeatedly during conversations surrounding long term safety nets and one of the most frequent has been the need to tackle the entire problem, not just the issue of being unable to meet mortgage payments in isolation. We are seeing society carrying high levels of debt to greater numbers of creditors and spending an increasing amount of income servicing that debt. Whilst use of credit is a useful tool to manage finance when planned for and used appropriately, the levels of debt which some households are carrying is excessive. By way of example The Institute for Financial Inclusion report, Debt and Household Income found that households on incomes of £13,500 or less had total debts worth 6.4 times income. The various rules imposed upon lenders means that mortgage payments are a small piece of the debt jigsaw. Responsible lending must of course be balanced with responsible borrowing, but there should be better assessment of the entire debt picture before any form of credit is extended.

Another theme which emerged repeatedly is the desperation with which some people have sought to enter the housing market. This has partly been due to the historically fast rises seen in property prices in the early 2000s, and people not wanting to 'miss the boat' and be priced out of the market permanently. The private rented sector is characterised by relatively short-term tenancy agreements and consumers should not be driven to buy a property through a lack of security of tenure in the private rented sector. This is an area which needs further investigation to examine consumer needs and the effect which longer tenancy agreements might have on supply of housing and buy to let finance to the private rented sector.

Finally, various people noted the cyclical reoccurrence of repossessions and that the initiatives surrounding repossessions seem to wax and wane along with the media interest in the subject. We should have a consistent approach to preventing repossessions which is not a panic-driven response to economic conditions. Government, industry and regulators have rightly responded to the recession, but the changes made must work for the long term. We have seen that repossessions occur in general, not through people borrowing recklessly on their mortgages, but through being the victim of unexpected life events. Although some of these events do tend to occur more frequently during a recession (eg unemployment), others can happen to anyone at any time (eg ill health). This is why we must have solutions which work at any point in the economic cycle.

The costs of repossession to families, lenders and government are high, both in monetary and emotional terms. Government has an important role in preventing repossession, but so do others including lenders, insurers and advice agencies. These groups must work together to reduce the affliction of repossessions.

I would like to thank those who gave their time be involved in this work, and express my hope that the recommendations are acted upon to help those at risk of losing their home.

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