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| Title: Welfare Reform and Work Bill: Impact Assessment for Converting Support for Mortgage Interest (SMI) from a benefit into a Loan Lead department or agency: Department for Work and Pensions Other departments or agencies: | Impact Assessment (IA) | | |
| | Date: July 2015 | | |
| | Stage: Final | | |
| | Source of intervention: Domestic | | |
| | Type of measure: Primary legislation | | |
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|--|---------------------|
| Summary: Intervention and Options | RPC Opinion: |
|--|---------------------|

| Cost of Preferred (or more likely) Option | | | |
|---|----------------------------|--|---|
| Total Net Present Value | Business Net Present Value | Net cost to business per year (EANCB on 2009 prices) | In scope of One-In, Two-Out? Measure qualifies as |
| -£50m | 0 | 0 | No In/Out/zero net cost |

What is the problem under consideration? Why is government intervention necessary?
Support for mortgage interest (SMI) currently pays interest on a claimant's mortgage while they are in receipt of Income Support (IS), income-based Jobseeker's Allowance (JSA), income-related Employment and Support Allowance (ESA), Pension Credit (PC) or Universal Credit (UC). This ensures that home owners are protected from repossession during periods of unemployment or sickness. To protect taxpayers we will convert support in to a loan as previous recipients have benefited from house price gains whilst receiving public support for their housing, which is not fair to the taxpayer. Converting SMI into an interest bearing loan means that the benefit will be financed in a more sustainable and equitable way.

What are the policy objectives and the intended effects?
Without the policy change a benefit is paid to those who are not working which enables continued build-up of equity in their homes. Support for homeowners, as for renters, when unemployed or sick is fair, but it is unfair to the taxpayer to subsidise assets for the homeowner. The policy increases the fairness of the welfare system by ensuring that the taxpayer recovers the value of payments made in support of an asset, instead of those benefits accruing solely to individuals. Maintaining the higher capital limit that was introduced as a temporary measure in January 2009 recognises the upward trend in house prices. A loan also ensures that individuals take responsibility for paying for their home, as it is an asset.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
1). Convert SMI to a loan from 2018/19 and increase the capital limit permanently to £200k from 2016/17.
2). Continue to pay SMI as a benefit and/or reduce the capital limit for SMI for working age claimants to £100k. This would be subject to increased costs if interest rates rise following an increase in the Bank of England base rate. A £100K capital limit would risk repossession for some claimants, particularly for those who took out their mortgages in the last decade.
3). Require SMI claimants to apply for equity release/lifetime mortgages and only where they are refused these products to be able to access SMI. This would be administratively complex and would, because of the requirements of equity release providers, only be available to claimants aged over 55.
Option 1 is the preferred policy as it provides a fairer way of supporting mortgage payers, within a constrained welfare budget.

Will the policy be reviewed? It will/will not be reviewed. **If applicable, set review date:** Month/Year

| | | | | | | |
|--|--|--------------------|----------------|--------------------|---------------------|--------------------|
| Does implementation go beyond minimum EU requirements? | | Yes / No / N/A | | | | |
| Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base. | | Micro No | < 20 No | Small No | Medium No | Large No |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | Traded: | | Non-traded: | |

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:  Date: 20/07/2015

Summary: Analysis & Evidence

Description:

FULL ECONOMIC ASSESSMENT

| | | | | | |
|---------------------------------|------------------------------|-------------------------------|--|-----------------------|-----------------------------|
| Price Base Year 14/15 | PV Base Year 15/16 | Time Period Years 5 | Net Benefit (Present Value (PV)) (£m) | | |
| | | | Low: Optional | High: Optional | Best Estimate: -£50m |

| COSTS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|----------------------|---|--|--|--------------------------------------|
| Low | Optional | | Optional | Optional |
| High | Optional | | Optional | Optional |
| Best Estimate | | | £130 | £650 |

Description and scale of key monetised costs by 'main affected groups'

The loans policy will result in costs to SMI customers equal to the amounts of SMI benefit that would otherwise have been paid, plus loan interest costs for those who take up the loans. In the period from 16/17 to 17/18, before the conversion to the loan scheme, there are Exchequer costs associated with increasing the capital limit to £200k in the current SMI scheme.

Costs also include the Exchequer costs of implementing the loans scheme.

Other key non-monetised costs by 'main affected groups'

| BENEFITS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|----------------------|---|--|--|---|
| Low | Optional | | Optional | Optional |
| High | Optional | | Optional | Optional |
| Best Estimate | | | £120m | £600 |

Description and scale of key monetised benefits by 'main affected groups'

Benefits reflect the discounted Exchequer savings, equal to the amounts of SMI benefit that would otherwise have been paid, plus loan interest received from borrowers. Savings arise because homeowners repay the Exchequer spending, which was previously a benefit, and from the expected reduction in take up compared with the current SMI policy. In the period from 16/17 to 17/18, there is also a benefit to SMI claimants from maintaining the increase in the capital limit to £200k limit.

Other key non-monetised benefits by 'main affected groups'

By converting SMI to a loan we can sustainably maintain the £200,000 capital limit and give homeowners an adequate safety net. We anticipate that this will prevent some people suffering repossession - a significant net benefit for society and the Exchequer preventing increased distress of repossession and resulting costs of Housing Benefit payments. Moving to a loan may also improve work incentives as some people may move back into work quicker to avoid increasing their debt.

Key assumptions/sensitivities/risks

Discount rate (%)

3.5%

BUSINESS ASSESSMENT (Option 1)

| | | | | |
|--|----------------------|-----------------|--------------------------|-----------------------------|
| Direct impact on business (Equivalent Annual) £m: | | | In scope of OITO? | Measure qualifies as |
| Costs: N/A | Benefits: N/A | Net: N/A | Yes/No | IN/OUT/Zero net cost |

Brief outline of policy or service

History of Support for Mortgage Interest (SMI)

There has been provision in the benefits system to support owner occupier claimants' mortgage interest payments since 1948. The prime objective has been to provide short-term help to prevent repossession by making a contribution towards mortgage interest payments while claimants took steps to move back into work. The growth of interest only mortgages from the 1980s and households taking mortgages into retirement will make this provision increasingly unsustainable. Without the policy change there is an incentive for households to allow the taxpayer to take the burden of their mortgage without taking steps to repay it themselves.

Currently there are 170,000 claimants receiving SMI at a cost of £265 million per annum. The total cost is relatively low at present, partially due to historically low interest levels. Ten years ago (2005/06) the cost of providing SMI was nearly £500 million per annum in 2014/15 prices; risk of expenditure returning to those levels remains in the absence of policy change. As SMI is a benefit, there is no mechanism for recouping any of the funds provided to the claimant, who benefits from taxpayers funding their accumulating wealth in property.

Policy proposals

The proposed policy is to change SMI from a benefit into a loan and to maintain the increase in the SMI limit on mortgage capital at £200,000 for working age claimants, a level to which it was increased as a temporary measure in January 2009. This is intended to make the system fairer to the taxpayer, whilst maintaining support for home owners who need it. The amount of SMI paid to any claimant (plus interest on that loan and an administration charge) would be recouped from the equity in the property when it is sold, or repaid when the claimant returns to work. If there is insufficient equity in a claimant's property to repay the whole SMI loan, the balance would be written off.

People who are acquiring a potentially valuable asset will in the future have the choice to receive a loan to support them, rather than a subsidy from the taxpayer. The scheme will continue to help protect homeowners from the threat of repossession in periods when they are unable to meet their normal mortgage payments as this loan is only repayable on moving back into work or on sale of the property.

The loan will be offered to owner-occupiers entitled to Income Support (IS), Jobseekers Allowance (JSA), Employment Support Allowance (ESA), Pension Credit (PC) or Universal Credit (UC). Those of working age will be offered a loan after they have served a 39 week qualifying period. The amount of loan available will be calculated by applying a standard interest rate to the amount of capital outstanding, subject to a maximum of £200,000 (£100,000 for pension age claimants).

Delivery of a loan scheme

DWP will be responsible for determining eligibility for loans and for making payments. As now, payments will be made direct to lenders to ensure their continued forbearance from repossessing SMI claimants. Independent external providers will be engaged to give pre-loan advice to claimants, register charges on claimants' properties and recover debts.

Rationale for changing SMI into a loan

The housing market has changed significantly since 1948. The upward trends in real house prices mean that many owners have accrued significant equity in their homes. The result is that people who are relatively 'asset rich' can nonetheless still access financial assistance from the taxpayer in the form of a benefit. Therefore extending support to people who experience temporary periods of unemployment or sickness whilst not increasing the burden to the taxpayer. Also, in 1948, it was very unusual for people to take mortgages into retirement but

now almost half of SMI recipients are pensioners, many of whom are likely to have interest only mortgages and receive support for significant periods into their retirement. In many of these cases the equity that has been secured at taxpayers' expense passes on to the claimant's heirs after their death. Transferring this benefit into a loan retains support in a sustainable way whilst providing increased fairness to the taxpayer.

Public consultation

A public consultation held between December 2011 and February 2012 trailed the idea of changing SMI from a benefit into an interest-bearing loan secured on claimants' properties. The vast majority of respondents supported the proposal. Details of the call for evidence can be found here <https://www.gov.uk/government/consultations/support-for-mortgage-interest-call-for-evidence>

Evidence and analysis

In 2013/14 in the UK, 17.2 million households were owner occupiers. Of these 8.9 million owned their property outright and 8.3 million were paying off a mortgage. Mortgagors are typically a middle-aged group, with two thirds aged between 35 and 55 years. The large majority (83%) of mortgagors are in full time employment.

Currently there are 170,000 claimants receiving SMI at a cost to the Exchequer of £265 million per annum. Around 55% of claimants are working age and 45% pension age.

By 2018/19 the cost of SMI is projected to be £250 million. The number of SMI claimants in that year is projected to be 160,000 (of whom 100,000 - 63% - are working age and 60,000 – 37% - are over pension age).

The cost of SMI is dependent on interest rates. If the average mortgage rate were to double, so would the cost of SMI, but converting to a loan will reduce the risk of additional costs to the tax payer from interest rate rises. This lower financial risk makes the scheme sustainable.

The policy will affect all those on SMI, though this is through repayments which are delayed until such time as recipients are financially able to repay this loan. Support remains available at the time of need, but at a higher level due to the increased capital limit on support. Households may choose not to take up this loan and alternatively finance their mortgage. Those who currently claim SMI and do take up the support will retain the level of support they currently have.

Exchequer Impacts

The following table shows the annual impact on the exchequer, showing that there is a cost impact in the first 2 years, due to the increase in capital limit, followed by savings. The table also shows how the Published OBR costing note figures are discounted to obtain the headline saving figure of £600m in this document.

| | 16/17 | 17/18 | 18/19 | 19/20 | 20/21 | Total |
|---|-------|-------|-------|-------|-------|-------|
| Savings from Published OBR Costing Note | -30 | -33 | 259 | 247 | 251 | 694 |
| Discounted Figures (3.5%) | -29 | -31 | 234 | 215 | 211 | 600 |

Impact on Protected Groups

The following sections examine the characteristics of current SMI claimants to illustrate – as far as possible - the likely impact of the policy on those with protected characteristics under the Equality Act 2010. In some cases, direct data is not available on SMI claimants with protected characteristics – available data on all mortgage payers is presented as a proxy measure, but may not be a reliable guide to the characteristics of SMI claimants.

Gender

The breakdown of SMI claimants by gender and family type show single females comprise almost half of the SMI caseload, with men being approximately three times less represented. These figures are from the Quarterly Statistical Extract, which does not contain information on ESA claimants in receipt of SMI.

Age

The distribution of SMI claimants between working age and pension age shows that, on average SMI claimants are considerably more likely to be over pension age than mortgage payers in general.

People of pension age will accumulate an SMI loan at a slower rate than those of working age as they receive smaller average weekly amounts. The average weekly award for pension credit customers in 2015/16 was £20, while it was £38 for someone in receipt of a working age benefit (2014/15 prices).

Children

Just over half of SMI customers have dependent children.

Disability

18% of mortgagors have one or more disabilities compared to 19% of the general population. Mortgagors are slightly less likely to have a disability than the general population.

In the general population people with disabilities are less likely to have an outstanding mortgage than those without disabilities. However we do not have data on the proportion of SMI customers who have a disability.

Ethnicity

Analysis of the Family Resources Survey of all mortgagors by ethnicity shows that 89% are white, 4% are Asian or Asian British, 2% are Indian and the remaining 5% are split equally between mixed or multiple ethnic groups, Pakistani, Black, African or Caribbean, other Asian background and Other.

Sexual orientation, religion and civil partnerships

There is no data available with respect to the, sexual orientation or religion of those claiming SMI nor in respect of those in civil partnerships.

Life Chances

The new Life Chances legislation (incorporated into the Welfare Reform and Work Bill) proposes to remove a number of the legal duties and measures set out in the Child Poverty Act 2010 and to place a new duty on the Secretary of State to report annually on children in workless households and the educational attainment of children. This is because evidence shows these to be the two main factors leading to child poverty now and in the future (respectively).

Replacing Support for Mortgage Interest as a benefit with a higher level of support as a loan is supportive of Life Chances as this policy will increase the level of support available at the time of need. This is intended to prevent repossession and distress to families, which could harm the family unit. Where homelessness is prevented it also enables return to work more quickly and therefore may have a longer term impact on stable family life of homeowners who are temporarily sick or unemployed.

Decision making

Three policy options were considered:

- Keep SMI as a benefit
- Convert SMI to a loan
- Require the use of equity release products when available.

Ministers considered the potential savings of converting SMI into a loan relative to retaining the benefit payments. It was decided that to increase fairness to taxpayers and to ensure that those with large assets don't benefit from financial assistance from the taxpayer by converting SMI to a loan.

Annex A.

Estimating the static costing:

The policy was costed using a dynamic micro simulation model. The model uses an SMI population generated from DWP forecasts.

The population is then assigned parameters such as how much equity they have in their home, and how likely they are to sell their home, based on their age. The model then projects the likely build-up of SMI loans, interest paid on loans and the amounts repaid. Some of the main assumptions used in the modelling are set out below.

- The amount available as an SMI loan will be calculated by applying the Standard Interest Rate (which is currently 3.12%) to the eligible outstanding mortgage capital amount. The limit of outstanding capital on which we will pay SMI loans will be £200,000, for new PC claims this will be £100,000.
- SMI loans will carry an interest rate equal to the gilt rate, and this interest rate will be revised every six months. This is lower than market rates.
- Customers claiming SMI through a working age benefit will be subject to a 39 week waiting period, as is the case under the current SMI policy. There is no waiting period for Pension Credit customers.
- We assume that the third party provider will recover loans in a timely manner according to industry standards. Recovery will be a combination of loan repayments when customers return to work and recovery from house values when the property is sold.
- A small proportion of loans are assumed to be written off in due course where there is inadequate equity to recover the loan, but no write-offs are assumed in the period covered by this IA.
- We assume that 5% of working age claimants (those claiming through JSA, ESA or IS) and 8% of those of pension age will choose not to receive SMI when it is converted to an interest bearing loan (based on an analysis that indicates these are the proportions of each group who have access to funds from other sources, for example beneficiaries or parents). This take up assumption implies that 5,000 working age (5% of 101,000) and 4,700 pension age (8% of 59,000) claimants will choose not to take a loan.