Title: Converting Support for Mortgage Interest (SMI) from a benefit into a loan (Northern Ireland) **IA No:** **RPC Reference No:** **Lead department or agency:** **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 23/08/2017 **Stage:** Development/Options **Source of intervention:** Domestic **Type of measure:** Primary legislation **Contact for enquiries:** Joseph Simmons 02074497111

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANDCB in 2014 prices)	**One-In, Three-Out**	**Business Impact Target Status**
£25m	£0	£0	Not in scope	Not a regulatory provision

What is the problem under consideration? Why is government intervention necessary?

Support for mortgage interest (SMI) currently contributes towards 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). Working age claimants serve a 39 week qualifying period. This ensures that home owners receiving these benefits are protected from repossession during periods of unemployment, sickness or retirement. To provide a better deal for taxpayers we will convert support into an interest bearing loan, which will be repayable from any remaining equity when the property is eventually sold (or earlier if the claimant is able and so wishes).

What are the policy objectives and the intended effects?

The policy gives claimants the same level of protection against repossession they enjoy under the existing regime but offers a better deal to the taxpayer by ensuring that the payments made to secure a potentially valuable asset can be recouped. The policy also places the financing of SMI on a more sustainable basis, with much of the AME cost of the policy eventually being recovered. As part of the Fresh Start agreement we agreed with the Northern Ireland Assembley that parity across the UK on social security would be restored. This policy change will bring Northern Ireland into line with incoming changes in the UK.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

1) Convert SMI to an interest-bearing loan from 2018/19, with interest set at forecast gilt rate of borrowing.
2) Convert to an interest-free loan
3) Convert to a higher interest loan.
4) Continue to pay SMI as a benefit and/or reduce the capital limit for SMI for working age claimants to £100k. This would increase the risk of repossession for claimants with more expensive homes.
5) Require SMI claimants to demonstrate that they have applied for and been refused equity release/lifetime mortgages. This would be administratively complex and would be available only to claimants aged over 55.

Option 1 is the preferred policy as it provides a fairer and more sustainable way of supporting mortgage payers, within a constrained welfare budget. Setting interest at forecast gilt rate ensures the cost of lending is covered by the claimant.

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

Does implementation go beyond minimum EU requirements?	N/A			
Are any of these organisations in scope?	**Micro** 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: 31st August 2017

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 1718	PV Base Year 1718	Time Period Years 4	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** £25m

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	£2.0m		£1m	**£5m**

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

Costs are calculated relative to a baseline of SMI continuing as a benefit for the duration of the current spending period (2017/18 till 2020/21). Costs to the Exchequer to implement the loan (£2m transitional costs). Annual costs to monitor and recover loans (£1m), plus loans written off (£2m) are £3m. Total costs are £5.8m, discounted to £5.6m. Costs to the claimaint occur from reduced equity in their property is realised when the property is sold.

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

Claimant costs have been excluded from the NPV calculations as they occur at an unknown time in the future and are taken from proceeds of the property sale, which may be after the claimants death. However in the absence of this change the proceeds may not have occurred were the property to have been repossessed.

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	£0		£8m	**£31m**

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

Savings to the Exchequer are equal to the amount of SMI benefit that would otherwise have been paid, plus interest on the amount of SMI paid as a loan, with an adjustment for estimated lower take up. These are estimated at £33m over four years, which discounts to £31m. Savings arise through lower take up of SMI and because homeowners repay the Exchequer spending which was previously a benefit.

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

By converting SMI to a loan we can sustainably maintain a safety net for homeowners. 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%

Assumes no change in the standard interest rate of 2.61% at which SMI entitlement is calculated, in line with OBR forecasts. Eligbility for SMI from unemployment benefits (JSA/UC) is senstive to changes in the employment rate. Write offs (cost to Treasury) assume an equal proportion of loans advanced are lost annually (9%), loans written off will be sensitive to changes in the economy and housing market. Assume GB assumptions apply where separate figures for NI not available.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target (qualifying provisions only) £m:**
Costs:	**Benefits:** N/A	**Net:** N/A	N/A

Evidence Base

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 make this provision increasingly unsustainable in the event interest rates rise. 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 an estimated 11,000 claimants receiving SMI in Northern Ireland at a cost of £9 million per annum (2017/18). The total cost is relatively low at present, partially due to historically low interest rates. Risk of increased expenditure remains high in the absence of policy change, given the likelihood of future interest rate rises. 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.

In the Fresh Start Agreement[1], the Northern Ireland Executive agreed an approach to implementing welfare reform in Northern Ireland. The deal reached included agreement for the UK Government to legislate for welfare reform in Northern Ireland. These changes to SMI, flowing from the Welfare Reform and Work (Northern Ireland) Order 2016, are part of that agreement.

Policy proposals
The proposed policy is to change SMI from a benefit into a loan. 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) would be recouped from the equity in the property when it is sold, or repaid voluntarily 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 the maximum outstanding capital limit of £200,000 (£100,000 for pension age claimants) which is being retained.

Delivery of a loan scheme
Department for Communities will be responsible for determining eligibility for loans, making payments, registering charges on claimants' properties and recovering debts. As now, payments will usually be made direct to lenders to ensure their continued forbearance from repossessing SMI claimants. An independent external provider will be engaged to give pre-loan information to claimants.

[1] https://www.northernireland.gov.uk/sites/default/files/publications/nigov/a-fresh-start-stormont-agreement_0.pdf

Rationale for changing SMI into a loan
The housing market has changed significantly since 1948. The upward trend 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. Also, in 1948, it was very unusual for people to take mortgages into retirement but now almost half of GB SMI recipients are pensioners and 28% of SMI recipients in Northern Ireland claim Pension Credit, 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 trialled 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 Great Britain there are 20.6 million owner occupied households (2014/15). Of these 51% owned outright and 49% are paying off a mortgage[2]. In NI 57% of owner occupied households are owned outright and 43% are paying of a mortgage. In GB half (49%) of mortgage holders, based on the lead respondent, are between 35 and 54 years, a third (34%) are younger than 35 and 16 per cent are 55 or over. The large majority (82%) of GB mortgage holders are in full time employment. There are currently an estimated 124,000 SMI claimants in GB, with around 48% in receipt of Pension Credit and so of pension age; the remaining 52% of SMI claimants are of working age[3]. It is not currently possible to provide all these equivalent figures for Northern Ireland. However, we do know that about 28% of SMI claimants in Northern Ireland claim Pension Credit (significantly lower than the 48% in GB) and 27% of SMI claimants in NI are aged 65+.

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 future interest rate rises. This lower financial risk to the exchequer makes the scheme more 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. Nevertheless, support remains available at the time of need. Households may choose not to take up this loan and finance their mortgage repayments in alternative ways. Those who currently claim SMI and do take up the support will retain the level of support they currently have.

Exchequer Impacts
The table shows estimated savings, to the exchequer from SMI being paid as a loan rather than a benefit. In line with the original OBR estimates, interest is accrued on loans based on OBR gilt rate forecasts, and nine per cent of SMI loans are assumed to be written off and are excluded from savings[4]. Savings are also net of transitional and administrative costs. The table shows how the figures are discounted to a base price year 2017/18 to obtain the headline saving figure of £25m in this document.

[2] Family Resources Survey 2014/15.

[3] Estimated from the Quarterly Statistical Extract, which is a 5% sample.

[4] Assumption based on analysis of claimants in arrears on a sample of SMI claimants held by the Council for Mortgage Lenders.

All figures £m	17-18	18-19	19-20	20-21	Total
Estimated benefit savings	-	10.5	10.6	10.7	26.9
Interest on SMI loans	-	0.1	0.3	0.5	0.8
Total benefits	**-**	**10.6**	**10.9**	**11.2**	**32.8**
Total benefits discounted (3.5%)	**-**	**10.3**	**10.2**	**10.1**	**30.6**
Loans written off	-	0.9	0.9	0.9	2.3
Transitional costs	2.0	-	-	-	2.0
Additional admin costs	-	0.4	0.4	0.4	1.1
Total costs	**2.0**	**1.3**	**1.3**	**1.3**	**5.8**
Total costs discounted (3.5%)	**2.0**	**1.2**	**1.2**	**1.2**	**5.6**
Estimated net savings	**-2.0**	**9.4**	**9.7**	**9.9**	**27.0**
Discounted Figures (3.5%)	**-2.0**	**9.1**	**9.0**	**9.0**	**25.0**

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 much of this we use FRS data for GB in the absence of NI data and assume the NI population is similar.

Administrative data is not available on SMI claimants with protected characteristics. Analysis has been conducted on mortgage holders in receipt of eligible income-based benefits (JSA, ESA, IS and PC), and compared to all mortgage holders, on the Family Resources Survey as a proxy measure of impacts on protected groups. The analysis should therefore be treated as an indicative guide to impacts on protected groups. The FRS data presented here is for GB, however there is no reason to assume the figures for Northern Ireland would differ significantly.

SMI as a loan will be available to all the claimants who can currently access it as a benefit and will not involve any customers losing income at the point of claim so there should be no adverse impact on claimants with protected characteristics. The amount of SMI paid to any claimant plus interest on that loan will be recouped from the equity in the property when it is sold or otherwise disposed of. If there is insufficient equity in the property to repay the whole SMI loan, the balance will be written off. Thus there will be continued protection from the threat of repossession regardless of protected characteristics.

Gender
The breakdown of SMI claimants by gender and family type show 33 per cent of the proxy group for SMI claimants are mixed sex couples, 41% are single females and a quarter (26%) single males. There is a higher proportion of single females compared to mortgagors because Pension Credit claimants and Income Support claimants are disproportionately single females compared to mortgagors. These figures are for GB. In Northern Ireland 56% of SMI claimants are female and 44% are male.

Age
The proportion of the SMI proxy group aged 65 or over in GB is larger (45%) than the proportion of mortgage holders (4%), showing SMI claimants are considerably more likely to be over pension age than mortgage payers in general. In Northern Ireland 27% of the SMI caseload is aged 65 or over.

People of pension age will typically accumulate their SMI loan at a slower rate than those of working age as they receive smaller average weekly amounts (because the value of outstanding capital typically falls with age). The average weekly award for pension credit customers in 2016/17 was around £20, while it was around £40 for someone in receipt of a working age benefit.

Children
The Family Resources Survey data shows that fewer people in the SMI proxy group (15%) have dependent children compared to all mortgage holders in the survey (36%). The proportion of SMI claimants with dependent children is smaller than mortgage holder because SMI claimants are disproportionately pension age compared to mortgage holders.

Disability
Over one third (38%) of SMI recipients are claiming ESA (38%) and almost half (48%) are claiming Pension Credit (48%). Equivalent figures for NI are 49% claiming ESA and 28% claiming Pension Credit. Claimants of these benefits are more likely to be affected by some form of disability that the population in general. Based on self-reported data on disability status according to the Equalities Act 2010 definition, in the proxy group for SMI claimants in GB 74 per cent of single claimants are disabled and 80 per cent of couple claimants have one or more member that is disabled. In comparison, 17 per cent of all single mortgagors have a disability and 21 per cent of couples with mortgages have a member with a disability. This indicates the policy is likely to have a disproportionate impact on disabled people. All SMI claimants will continue to be protected from the threat of repossession regardless of disability status.

Ethnicity
Analysis of the Family Resources Survey finds 16 per cent of the proxy for SMI claimants on the survey are from a BME group, compared to 12 per cent of mortgage holders in the general population.

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 Act 2016) 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 the same level of support as a loan will continue to support Life Chances as this policy will ensure support remains available at the time of need. The intention is to continue 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

Several policy options were considered:

- Keep SMI as a benefit
- Convert SMI to an interest-bearing loan
- Require the use of equity release products when available.
- Convert SMI to an interest-free loan
- Convert SMI to a high interest loan

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

Annex A - estimating the static costing

The policy was costed using a dynamic micro simulation model and uses the same methodology to estimate savings from converting SMI to a loan as the original OBR estimates at Summer Budget 2015. The estimates here use estimates and methodology consistent with the GB SMI Impact Assessment but adjusted proportionately to reflect the lower caseload in NI.

The model uses an SMI population generated from DWP forecasts. The population is 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 2.61%) 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. An increase in the Standard Interest Rate would increase the cost of future SMI payments (and therefore increase forecast exchequer savings from moving to a loan).
- SMI loans will carry an interest rate equal to the forecast gilt rate (currently 1.7%), and this interest rate will be revised every six months. This is typically 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 (9%) in due course where there is inadequate equity to recover the loan.
- We assume that 5% of eligible working age claimants (those claiming through JSA, ESA or IS) and 8% of eligible pension age claimants 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).