EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (HOUSING COSTS) (STANDARD INTEREST RATE) AMENDMENT REGULATIONS 2010

2010 No. 1811

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 Claimants in receipt of income support, an income-related employment and support allowance, income-based jobseeker's allowance or state pension credit may be entitled to help towards their housing costs. Specifically, this help covers eligible interest on loans (up to prescribed capital limits) taken out to purchase a home and on certain home improvement loans.

2.2 This instrument amends the standard interest rate which is used to calculate the amount of interest payable on a qualifying loan. The instrument replaces the current fixed standard interest rate of 6.08% with a rate based on the average interest rate for loans to households secured on dwellings published by the Bank of England (*see* paragraph 7.1 for an explanation of where this rate can be found).

2.3 The initial starting rate will be the rate published in August 2010. Thereafter, the standard interest rate will be subject to change where the Bank of England published average rate differs from the standard rate by 0.5% or more.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 Since 1995, the help towards interest on mortgage loans and home improvement loans for claimants has been calculated by applying a standard interest rate to the capital outstanding on the eligible loan or loans. Any interest paid in excess of a claimant's actual mortgage interest is applied first to pay off any arrears of mortgage interest and then to repay the principal sum of that mortgage or any other liability to the qualifying lender in respect of that mortgage.

4.2 From December 2004, the standard interest rate was based on a formula: the Bank of England Base Rate plus 1.58%.

4.3 From November 2008, the standard interest rate was fixed at 6.08%. The Government has decided that this rate is too high and therefore unsustainable. For that reason it has decided to change the standard interest rate to a rate based on the average interest rate published by the Bank of England for loans to households secured on dwellings on the grounds that this will continue to provide claimants with protection against repossession at the same time as providing better value for money to the taxpayer and addressing the deficit.

4.4 The recent decision to change the standard interest rate from the fixed rate of 6.08% to the Bank of England average rate was announced by the Chancellor as part of the Government's Emergency Budget on 22 June 2010 (Hansard, 22 June 2010, Column 174 http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100622/debtext/100622-0006.htm; Budget 2010 Redbook HC61, Chapter 1, page 35, paragraph 1.111 http://www.hm treasury.gov.uk/d/junebudget_complete.pdf)

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 To put help with mortgage interest on a more sustainable footing the Government has decided to move to a standard interest rate based on the Bank of England published average rate for loans to households secured on dwellings (3.66% in May 2010). The Government has selected this rate because it believes that this best represents an average of the rates that apply to claimants' mortgages whilst continuing to protect claimants against repossession. This rate is based on information from around 30 banks and building societies, covers over 75% of all banks and building societies' mortgage business and is a weighted average of all existing loans to households secured on dwellings from banks and building societies in the sample. It is specified in the first tab of Table G1.4 under the heading "CFM", column "HSDE" on the internet at: http://www.bankofengland.co.uk/statistics/bankstats/current/index.htm

7.2 The Department obtained a small sample of data in November 2009 from the Council of Mortgage Lenders. This data suggests that some 170,000 claimants with mortgage rates below 6.08% currently have no arrears on their mortgage accounts. Of the claimants with mortgage rates below 6.08%, over half are currently receiving support for mortgage interest payments that are at least 50% higher than the actual interest due to lenders on the eligible loan. The House of Lords Select Committee on the Merits of Statutory Instruments drew attention to this issue in paragraph 22 of its 16th report in the 2009-10 session as, “the underlying problem, that, through the generous interest rate, taxpayers are now funding payments that not only support mortgage interest but, for a significant proportion of claimants, begin to pay off capital, which was not the original policy intention”.

7.3 The Government further believes that, to provide certainty and transparency, the standard rate should initially be set at the Bank of England average rate for loans to households secured on dwellings published in August 2010. This would be introduced from 1 October 2010. Using the rate published in August will ensure that Jobcentre Plus and the Pension, Disability and Carers Service have time to implement the rate in their systems from October. Financial considerations were absolutely key in the decision to introduce these changes from October. The decision to change the standard interest rate was made very shortly before the Emergency Budget. This timeframe was intended to allow sufficient time for the proposals to be considered by the Social Security Advisory Committee and for the Committee to require the proposals to be formally referred to it, if it deemed it appropriate, and for the Secretary of State to respond to any recommendations made by the Committee.

7.4 Future changes in the standard interest rate will not replicate the Bank of England published average rate. This is because, for simplicity of operation and to avoid minor adjustments, changes in the standard interest rate will only be triggered when the Bank of England’s published average mortgage rate and the standard rate in payment differ by 0.5% or more. When that occurs, the Bank of England published average rate becomes the new standard rate, with those changes taking effect on a day to be specified by the Secretary of State for the purposes of calculating the weekly amount of housing costs to which a claimant is entitled. In practice, it takes around 5 to 6 weeks to implement a change to amend the standard rate in the Department’s computer systems and implement the change to benefit awards.

7.5 Under a standard interest rate of around 3.66%, about 50% of support for mortgage interest claimants would continue to have their eligible housing costs met in full by their benefit award. 52% of support for mortgage interest claimants would have at least 90% of their eligible mortgage interest outgoings covered by their benefit awards and 93% of claimants would have at least 60% of their outgoings covered.

7.6 The Government does not believe it is appropriate to revert to the previous formula for the standard interest rate – that is, setting it at the Bank of England Base Rate plus 1.58%. This would currently result in a rate of 2.08% and could create a risk of repossession for a significant number of claimants.

7.7 In the recent past, some people and organisations have said that the fairest approach would be to move away from the standard interest rate and to move towards paying the actual rate charged under each loan. However, this method was used in the past and caused very considerable problems. This is because it relied on claimants informing the Department of rate changes and led to very substantial overpayments, fraud and error and administrative problems, primarily because claimants did not always report changes in their interest rates to the Department. The Council of Mortgage Lenders has told us that lenders would not be able to report changes in claimants' mortgage rates to the Department because, in many cases, their systems would not support this.

7.8 The Government's policy is to avoid repossessions as far as possible. The Government recognises that the threat of repossession remains very real for homeowners across the country – with challenges ahead when interest rates start to rise. The Government will continue to work closely with lenders and debt advice agencies to ensure repossession is only ever a last resort; and expects to see lenders continuing to offer support and forbearance to their borrowers who are struggling with their mortgage payments. The Council of Mortgage Lenders has told us that:

> "lenders will continue to exercise forbearance where it is fair to do so for the borrower, and the borrower has a chance of rehabilitation. Although arrears levels may increase for those few borrowers whose new Support for Mortgage Interest payment does not cover their mortgage, this does not translate into an immediate possession risk.".

Consolidation

7.9 An informal consolidated text will be available to the public free of charge via "The Law Relating to Social Security" (Blue Volumes), on the Department for Work and Pensions website at
http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/

8. Consultation outcome

8.1 As set out at paragraph 4.4 above, the new method for determining the standard rate was announced as part of the Chancellor's Emergency Budget on 22 June. So there has been no formal public consultation on this instrument. Informal discussions took place with the Council of Mortgage Lenders in advance of the Chancellor's announcement. The Council of Mortgage Lenders agreed that the rate of 6.08% is high, and accepted that there is a strong case for reducing it, particularly in the light of the deficit. They said that a reduction in the standard rate to between 3 and 4 % would not of itself drive repossessions.

8.2 The proposals for regulations were considered by the Social Security Advisory Committee on 7 July 2010. The Committee decided not to require the proposals to be formally referred to it.

9. Guidance

9.1 Manual input of the new standard interest rate by frontline staff will not be necessary as the rate will be updated on the Department's benefit systems in advance of the date of change, following existing procedures. This will trigger the issue of letters to claimants notifying them in advance of the change in the interest rate. Guidance will be issued to staff about the change in the rate, including advice about handling queries.

9.2 The Department will write to organisations that represent claimants such as the Citizens Advice Bureau in advance of the change to notify them of the level of the new standard rate. The Department will also ensure that the standard rate continues to be publicised through Directgov so that claimants, mortgage lenders and welfare rights advisers are aware of the current rate.

10. Impact

10.1 There is no direct impact on business, charities or voluntary bodies.

10.2 The impact on the public sector is negligible because the new standard interest rate will be changed automatically on computer systems and payments will be adjusted accordingly.

10.3 A full impact assessment has not been prepared for this instrument.

11 Regulating small business

The legislation does not apply to small business.

12 Monitoring & review

12.1 The success criteria for this instrument are that:

- no immediate risk of repossession to claimants receiving support for mortgage interest is created;
- the rate strikes a reasonable balance between fairness to claimants and value for money for the taxpayer; and
- that it is practicable administratively.

12.2 Over the last year the Department has undertaken a considerable amount of work to improve its evidence base and gain a greater understanding of support for mortgage interest claimants. The Department has:

- almost completed work to create a new, robust and more timely data series on support for mortgage interest claimants;
- commissioned a consortium of the Universities of Glasgow, York and Cambridge, working with Ipsos MORI to undertake a primary research project on support for mortgage interest claimants;
- in partnership with the Department for Communities and Local Government, almost completed work to develop a model which can assess the potential impacts of any changes to support for mortgage interest on repossessions.

12.3 At the same time, the Department has been working with the Council of Mortgage Lenders and the Benefit Delivery Centres to get a baseline of interest rates paid by support for mortgage interest claimants in the months prior to the change in the standard interest rate, and have complemented this with market wide data on mortgages and repossessions to inform the decision on an appropriate level at which to set the standard interest rate.

12.4 The Department will look to refresh this data on claimant rates, and bring in further market evidence to refine its modelling and understanding of the impact of any changes in the standard interest rate - in particular on the level of shortfalls and repossessions. The Department will use this data and modelling to evaluate whether or not the new standard interest rate formula is working effectively around a year after the change is introduced, when the impact can be fully assessed.

12.5 The Department does not capture information on reasons for ending a benefit claim, including support for mortgage interest, so does not capture the number of claimants who no longer receive support for mortgage interest payments because their property has been repossessed. As noted, the Department has almost completed development of a model to estimate the impact of changes to support for mortgage interest on the number of repossessions. But, any estimates will always be limited since detailed case-by-case information, such as initial arrears, is required to make an accurate estimate. In the absence of this personal information the Department, in conjunction with the Department for Communities and Local Government, can only make a best estimate of claimant circumstances in order to model repossessions as accurately as possible.

13. Contact

13.1 Nina Young at the Department for Work and Pensions (Tel: 0207 449 5351) or email: nina.young@dwp.gsi.gov.uk can answer any queries regarding the instrument.