Low income owner-occupation

in Scotland

Paul Spicker

Published by Shelter Scottish Campaign for Homeless People

ISBN 0 903921 54 5

Printed and bound by Hugh K Clarksons and Sons Ltd, Young Street, West Calder, West Lothian

Contents

Foreword

The accustomed stereotype of the 1990s is that all is well with home ownership in Scotland. This simple stereotype might serve for comparison with more troubled market conditions in England but it disguises rather too much to be useful.

Home ownership has grown faster in Scotland that anywhere else in Europe. The government has set a target that sixty per cent of Scots should be home-owners by the end of the current Parliament. And the housing minister talks of pushing the boundaries still further, targeting new and lower income groups. At the same time the benefit safety net for owner occupiers is being cut.

It has been a period of great change in the financial sector as well. Banks and building societies in 1996 bear little resemblance to the same organisations (if they still exist) which were around only twelve or thirteen years ago.

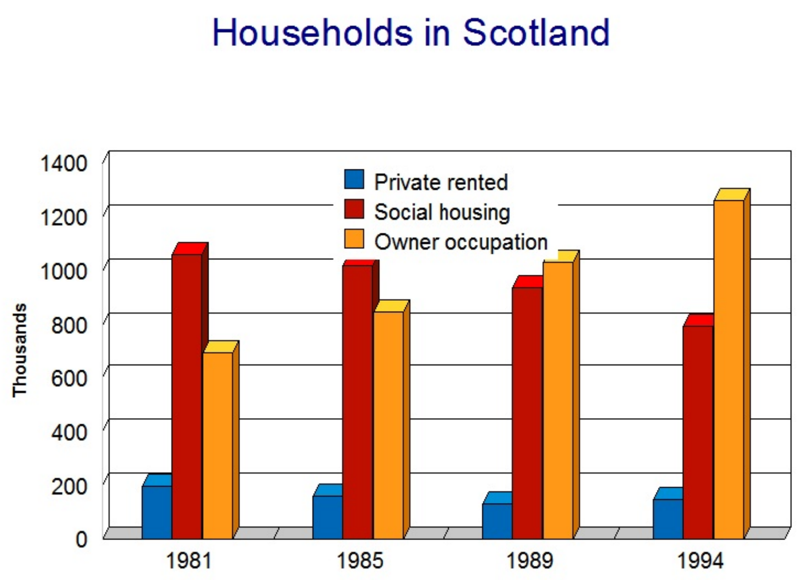
Shelter wanted to find out how appropriate the policies and practices adopted by lenders in Scotland were, both in light of their rapidly changing roles and in the context of enormous change in Scottish housing. In particular, we wanted to find out how fully lenders could cope with the needs and problems of low income home-owners. In the course of a relatively small scale enquiry Paul Spicker has unearthed many issues which deserve far more attention.

Liz Nicholson

Director, Shelter Scotland.

Low income owner-occupation in Scotland

Owner-occupation has often been seen as a tenure for the middle classes. This is probably more true in Scotland than in the rest of the United Kingdom; until fairly recently, local authority housing provided more than half all the available housing in Scotland. In 1981, under 36% of the housing stock was owner-occupied; by 1994, this had risen to 57%.[1] Local authority housing, over the same period, has fallen from 53% of the housing stock to 33%. Owner-occupation in Scotland has a long way to go before it reaches the proportions in England (68% of all housing in 1994), but as the numbers of local authority houses have fallen, and with them opportunities for access to good rented housing, owner-occupation has become progressively more attractive.



Part of the reason for the increase is that owner occupation has also been, by contrast with rented housing, heavily subsidised. Although the level of MIRAS has now fallen, it is still available; between 1979 and 1994, £4.55 billion went to owner-occupiers in Scotland.

House prices in Scotland have increased in recent years - a rise in price of 112%, and equivalent in real terms to 32% - between 1984 and 1994.[2] However, because Scottish housing did not suffer the level of inflation experienced in England in the late 1980s, it also did not suffer the subsequent falls in price. A survey for Britannia Building Society found that confidence in the housing market was much stronger in Scotland than in the rest of Britain, and that house prices were far less likely in Scotland to have fallen.[3] However, house prices in much of Scotland are still low by comparison with some other parts of Britain; the average house price is 80% of the UK average.[4] The relatively low prices mean that although there are considerable problems of access in some parts of the country - for example, in rural areas where stocks are limited - there are still many opportunities to buy housing even when income is relatively low. 7% of households who are buying a property with a mortgage - about one house in 14 - have a gross household income below £160 per week. About one household in every nine has an income below £200 per week.[5]

Low income owner-occupation has become possible mainly because the finance is available. Building societies and banks provide mortgages, in most cases, up to 95% of valuation, and in most cases they will give mortgages which are three times annual income. For a person earning £10,000 per year, this would mean a mortgage of up to £30,000. Other examples are given in table 1.

Table 1: Buying a house on a low income

Annual income	Weekly income	Mortgage (95%)	Deposit (5%)	Value of property	Monthly repayment at 8.0% over 25 years (illustrative cost)[6]	Weekly equivalent
£ 6,000	£115.38	£18,000	£ 947	£18,947	£124.92	£ 28.82
£ 7,000	£134.62	£21,000	£1105	£22,105	£145.74	£ 33.63
£ 8,000	£153.85	£24,000	£1263	£25,263	£166.56	£ 38.44
£ 9,000	£173.08	£27,000	£1421	£28,421	£187.38	£ 43.24
£10,000	£192.31	£30,000	£1579	£31,579	£208.20	£ 48.05
£11,000	£211.54	£33,000	£1737	£34,737	£231.36	£ 53.39

These figures are illustrative. Mortgage repayments can be lower or higher, depending on the rate of interest and the period of the loan; the amount of tax relief on the mortgage is likely to fall over time; there may be additional expenses (including costs related to arrangement of the mortgage, insurance payments and, particularly for tenements, the cost of factoring) which are not immediately obvious. The figures are enough, however, to explain how people on very low incomes may be able to buy a house. A couple with one child who have only £9,000 a year are likely to be entitled to receive Family Credit, which is a means tested benefit for people on low wages; but if they can only raise a deposit and the legal fees, they can still buy a property worth £28,000, and their repayments seem to compare very favourably with the cost of renting.

Although the situation offers important opportunities to people on fairly low incomes, it also has attendant risks. The extension of owner-occupation into lower income brackets means that the insecurity often associated with these incomes can be reflected in their housing situation. Because mortgages are geared to people's ability to pay, the problems which occur most usually occur when there is some change in circumstances - most typically, unemployment and martial breakdown. The benefits system used to protect people against such changes: owner-occupiers without other income used formerly to receive interest payments on their mortgage, which was generally enough to secure their property. But the rules have progressively changed. Recently the government has reduced the entitlements of owner-occupiers. The gap is supposed to be filled by private insurance, but the terms on which protection is available are generally restrictive.

The options which are open to low income owner-occupiers in difficulties are also limited. In a fairly flat housing market (which the Halifax's data suggest is currently true of Scotland) people do not gain on their mortgages. People who have bought at the lowest end of the market do not have the option to trade down.

All this means that the kinds of consideration which in times past were mainly confined to tenants - problems of insecurity, social protection, inadequate income and loss of people's homes - have become important considerations for a part of the market of owner-occupied housing. This report is an attempt to identify some of the problems, and how they are responded to.

Method

This report outlines the results of an enquiry made to mortgage lenders operating in Scotland, and to Scottish advice agencies, about low-income owner-occupation. Replies were received from 17 mortgage lenders; three others declined.

Mortgage lenders were asked:

1. What conditions do you require people on low incomes to meet in order to get a mortgage?
2. What are your procedures for dealing with people in debt? What kinds of problems emerge?
3. What problems do you encounter when a marriage breaks down?
4. What problems do you encounter in relation to people receiving social security benefits?

Advice agencies were asked:

1. Have you encountered problems which occur from the kinds of finance which people take up when they arrange their mortgage?
2. What kinds of problems emerge when people are in debt?
3. What problems do you encounter in relation to home ownership when a marriage breaks down?
4. What problems do you encounter in relation to owner-occupiers who receive social security benefits?

The replies to this enquiry are the basis for the material which follows. The Council for Mortgage Lenders estimates that the lenders who replied account for about 90% of lending in Scotland.

Buying a house

Purchase

It is not usually difficult to raise the purchase price on a property. Most lenders have no special rules for people on low income, applying the same conditions to people on low incomes as for those on higher incomes. This is because the situation of the low-income owner-occupier is fairly typical; most borrowers are first time buyers, and over half of them are under 35.

In general, lenders will usually cover up to 95% of the valuation of the property. The valuation is not necessarily the full purchase price, of course; partly, this is because the price of purchase includes goods (like carpets or kitchen equipment) which are not included in the valuation of the property, and also because the Scottish system of purchase can require people to bid above valuation in order to obtain the property.

There are also a range of additional costs associated with purchasing. This includes legal fees (normally, in Scotland, about 1% of the valuation), the mortgage valuation (probably about £140), the lender's legal fee (usually in the region of £120), the cost of arranging the loan, other requirements such as searches and recording dues, and an initial payment on buildings insurance. Most of these charges are quoted without VAT, which has to be added on. The largest single payment in this list is the cost of arranging loans, which is higher for mortgages above 75% of valuation: on a 95% mortgage of £30,000, Abbey National charge £465, and Northern Rock £656, but even without these fees the cost would fall in the upper hundreds. These prices should properly speaking be included in quotations to prospective lenders.

The effect of financial deregulation in the 1980s was often to combine mortgage provision with the sale of other financial services, and some Citizens Advice Bureaux commented that these extra costs are often compounded by 'up-selling'. Some mortgage lenders encourage borrowers to take on extra amounts on the mortgage to cover repairs and fittings. Often the mortgage comes in tandem with some other financial product: the Central Money Advice Project commented that

> "It is often not made clear enough which are recommended and which are necessary, e.g. life and payment protection insurance."

There are also often, in urban Scotland, extra costs associated with tenements. Bridgeton CAB pointed to a particular problem with common factors. Buyers find that they are required to pay fees for factoring in addition to their other payments, sometimes having to pay twice for buildings insurance; bills for maintenance are unpredictable and outside the buyer's control.

The Council for Mortgage Lenders has recognised that there are problems in the process of providing a mortgage, and it has issued a draft Code of Mortgage Lending Practice intended to protect borrowers, including basic information which borrowers should be given.[7] Its scope is limited, however, and there will be no direct power of enforcement.

Repaying the mortgage

The CML advises that "Mortgage loans should be made only to people who have the capacity to repay them."[8] In most cases, this is assessed by a formula, allowing three times gross income. If there are two earners, the option is to have an additional amount on the mortgage (usually equal to the second income) or alternatively to get a lower multiple of joint income: 2½ times at the Abbey National, Bank of Scotland, National and Provincial and the Woolwich. There are variations between lenders: the Royal Bank of Scotland gives more on a single income (3.25 times income), Northern Rock gives less on joint incomes (2.25 times joint income). The Bank of Scotland will go up to 4 times income for young borrowers with a parental guarantee for 20% of the borrowing.

Besides the formula, lenders will also examine people's ability to pay. The normal practice is to run a series of checks, including checks on identity; the applicant's previous borrowing record; any other financial commitments, and the security (that is, the value of the property). The lenders will also offer payment protection insurance.[9] The Halifax uses a 'mortgage scoring' system, based on information like credit references, references from the employer and the current lender, and proof that applicants have the necessary deposit. Fife Trading Standards expressed concern that the effect of a bad credit rating may be to push borrowers to get money from finance companies, who charge higher interest rates and are more ruthless if there are arrears.

The procedures to check the borrower's situation are designed, as much as anything, to protect the lender's interests. There are fewer checks as to whether an applicant can actually afford the property. Barclays Bank make detailed inquiries about income and expenditure; the TSB apply a general rule that expenditure should not exceed 40% of disposable income.

The problem with applying the formula to low incomes is that it can leave people with a very low disposable income. A couple with one child earning £9000 a year will have about £140 a week in take home pay, and about £160 a week once Child Benefit and Family Credit are taken into account. A mortgage of £40 a week is affordable in principle, leaving the family with £120 a week. Income Support for the same family would be £99.20 per week, and housing costs for tenants would be met by housing benefit. (The peculiarities of the benefits system mean, incidentally, that the results of these calculations produce a very similar differential across a surprisingly wide range of earnings.) The owner-occupier on a low wage will be better off than people out of work, then, but not by very much. These are very low levels of income, and it can be very difficult to manage on them. For the most part, the question of affordability is up to the discretion of the lenders. Cheltenham and Gloucester BS say that they deal with all cases 'individually'. Only one lender, Nationwide, has explicitly moved away from the use of the formula, considering ability to pay instead.

The advice agencies pointed to a general problem of people over-estimating their ability to pay, a problem which can be exacerbated by discounted rates which only apply for a limited period. Arrangements which penalise people for selling property early on in the mortgage period may work against someone who is trying to adjust to these circumstances.

Endowment versus repayment

For several years, the decision as to whether to take an endowment or a repayment mortgage has been fairly finely balanced; it is only recently that the disadvantages of endowments have become clearer. From the point of view of people on low incomes, there are two important considerations. The first is what happens when there is some interruption to income, through unemployment or disability. People on Income Support have generally received only the amount relating to interest; in the case of a repayment mortgage, this meant that near the beginning of the mortgage most of the mortgage is payable once a person is entitled; in the case of an endowment mortgage, it means that the full mortgage is payable, but not the amount of the insurance policy which is associated with the mortgage. This tends to mean that compensation is greater for people with repayment mortgages, particularly in the early years, and because borrowers have to pay their mortgages whether or not they have benefits to cover them, the extra has to come out of the basic benefit rates. Easterhouse CAB noted that people get locked in to unsatisfactory endowments, because the fee to meet cost of changing to another mortgage can't be met. This forces people in difficulties to take out a new endowment policy as part of arrangements to repay.

The second problem is that people who arrange mortgages have a strong incentive to sell endowments. Often they receive a direct commission. *Scotland on Sunday* recently reported the disturbing practice by which mortgage lenders are able within the law to mis-quote the price of a mortgage by basing estimates solely on early, discounted rates. They cite a manager from the Norwich Union as saying that "a greater proportion of endowment mortgages are still being sold by banks and building societies than is proper."[10] Central Money Advice commented that

> "Those selling mortgages often start from the assumption that an endowment mortgage will be taken... mortgages with tied insurance are often at favourable interest rates, but the customer does not realise that this may be negated by more expensive insurance policies."

The problem is exacerbated by the lack of good independent advice. About half of all home owners want to have better advice in general; in relation to options for mortgages and finance, the figure rises to 72%.[11]

Why people don't pay

The Council for Mortgage Lenders has commented that "most arrears result from relationship breakdown or severe loss of income, or frequently both." A limited ability to pay in the first place is less likely to be seen as a reason for getting into difficulties - partly because people try to take on commitments they can manage, and partly because people's incomes tend to rise over time, reducing the relative cost of repayments. Only the Woolwich Building Society commented that

> "Unemployment and relationship breakdowns are significant factors in default but by far the largest reasons given for failure to pay is financial mismanagement in all its aspects."

It is not surprising if people on very low incomes do not manage resources perfectly; few people do so. The effects of a miscalculation can, however, be very serious.

People on benefit

The lenders are used to dealing with people on benefit. The Britannia and National and Provincial have special teams to deal with the Department of Social Security; the N and P issue a leaflet about benefit entitlements. Britannia pointed to a number of problems, including inconsistent treatment of cases by different offices and mistakes in calculation. Alliance and Leicester comment on the general problem that, when the Benefits Agency start to pay towards the mortgage, "people now think they are no longer responsible for the mortgage because 'the DSS are paying it'." In general the benefits system will only pay for a part of the mortgage - excluding the capital component of a repayment mortgage, the premium associated with an endowment, and buildings insurance. These elements must still be paid. The calculations are complicated by the Benefits Agency's use of a 13 month year (Clydesdale Bank has a 'flexible' repayment period, which includes the option of fortnightly payment); in the near future the DSS will also be calculating repayments against a notional 'standard' rate rather than the amount people actually pay.

The lack of communication between lenders and the Benefits Agency arises because the lender has no direct interest in the claim; the money generally goes to the claimant, and it is none of the lender's business. But this also means that claimants get caught in the middle. Central Money Advice cited one case in which a Building Society moved its office, the Benefits Agency stopped paying direct payments because it didn't have the new address, and the claimants were threatened with repossession. Overpayments of benefit arise easily, because where mortgage rates have gone down, the payment to the claimant has not been adjusted in time. In cases where clients are overpaid, Britannia have offered to repay the money from the mortgage account, but the Benefits Agency insist on stopping the claimants' benefit instead.

Unemployment

Before 1988, owner-occupiers who became unemployed had the value of mortgage interest paid as part of Supplementary Benefit, along with a small allowance for other expenses like insurance. This meant that some people had very large benefit payments, and there were protests about people on benefit receiving more than the clerks who were paying them. It happened because the principle on which benefits given had been, since the beginning of the Welfare State, a principle of social security - making sure that people were protected against sudden changes in their circumstances - rather than insisting that they had a minimum income. The issue of incentives to work did not arise; anyone who had a large mortgage formerly had a larger income to match, and the incentive to restore that income was clear.

Since the introduction of Income Support, the rules have changed. At first, the entitlement of owner-occupiers was reduced, so that the mortgage was only covered in part for the first four months of unemployment. From October 1995, new rules mean that nothing will be paid for two months, there will be a further period of 19 weeks during which only half the interest is paid, and people with new mortgages will not be covered for 39 weeks. This kind of change is coupled with other changes in entitlement. People who were unemployed 'voluntarily', or sacked from their jobs for 'misconduct', used to get benefit suspended for up to 6 weeks; now it is 26 weeks. The changes in benefit rules are viewed with some apprehension: the Building Societies Association opposed the changes, and Abbey National, Barclays, Northern Rock, and Sun Banking all expressed concern that the situation would worsen. The Woolwich point out that people will now routinely be in arrears before benefit starts. Northern Rock commented that this could force lenders to take a tougher line:

> "The delay factor will now affect our thinking on how to treat borrowers with this problem and is likely to lead to a hardening of attitude if anything. Unfortunately low income groups are likely to suffer more than others in this area."

Most of the comments were based on apprehension about what is going to happen. Fife Trading Standards gave an early example of a case which has already happened.

> "One of our clients claimed Income Support in August 1995. They were evicted in December 1995 and the Benefits Agency decided in January 1996 that mortgage payments could have been awarded!"

The building societies have attempted to fill the gap in part by promoting private insurance: TSB comments that just over half their customers are taking it up. It is important to note that people working to fixed term contracts and seasonal work are not usually protected: Clydesdale Bank commented on "the lack of insurance available to large sections of the workforce.". The insurances are very restrictive in their terms. The Abbey National scheme, for example, excludes the first four weeks of a claim; voluntary unemployment or redundancy; short time working (which can leave people with an income lower than their mortgage repayment); unemployment at end of a contract of less than 12 months; the recurrence of a disability or illness happening in the preceding 2 years; attempted suicide, wilful exposure to danger, alcohol or drug abuse; pregnancy; 'wilful acts'; and unemployment after more than a month abroad. Lothian Trading Standards comment that "These insurances have serious discrepancies and pitfalls for customers", and Glenrothes CAB comments that people have already found that they "are covered for very little when it comes to the test".

Relationship breakdown

Relationship breakdown produces the thorniest, and most intractable, problems in this field. The problems facing any couple who are breaking up are whether either of them is able to stay in the home, and if so, who it should be; where the person who is moving out is going to go; and how the remaining mortgages are going to be paid for. Where people are in more expensive property, it may be possible for them to sell the property so that both partners can be housed. When the partners are both on a low income, and the value of the property is limited, the options are much more constrained. On one hand, the person who remains in the property may not have the ability to pay the mortgage. On the other, the person who is leaving usually leaves the children behind, and has no priority for rehousing by a local authority. The situation is one where, Glenrothes CAB suggest, both partners can find themselves becoming homeless.

The arrangement which usually costs the least for everyone is where one partner continues to live in the house. From the point of view of the government, the cost will usually be similar to payment of Housing Benefit, and perhaps less; from the lender's point of view, it means that the mortgage continues to be paid after a brief interregnum. The main problem is experienced by the partner who leaves, who is unable to realise anything from the sale of the property. However, this arrangement is often not made. The person who remains in the property often does not have enough income to pay the mortgage; the lenders undertake to look at the situation sympathetically, but often people's wish to stay in their home becomes impossible on the terms proposed. Most lenders are cautious about transferring a mortgage into a single name; Barclays state they will not do it if there are doubts about the ability of the remaining partner to repay.

In general, both parties in the case of relationship breakdown remain liable for payment of the mortgage; this remains true irrespective of any agreement between the parties, because they have a separate contract with the mortgage lender which makes them both 'jointly and severally' liable to pay. The Co-operative Insurance Society commented that

> "where the Court awards the property to one or other of the partners as part of the matrimonial settlement the customer who is not awarded the property often does not appreciate that they are still responsible for the mortgage debt".

The standard practice is for mortgage lenders to inform both parties as to their liabilities; Northern Rock commented that this is a time consuming business. Several lenders commented on the problems in very bitter divorces they may well find that neither partner is willing to pay. The Halifax also noted that

> "In addition, because the arrangements are agreed based on ability to pay it is normal for each party to have an arrangement for a different amount, It is usual with the Customer with the higher arrangement not to make payment as they do not appreciate why they are paying more than the other party."

The position is exacerbated because each partner remains liable for any arrears run up by the other. Fife Trading Standards remarked that the procedures cause 'untold animosity'.

The best option, National and Provincial suggest, is one which the parties are often reluctant to agree: the partners need to contact the lender and arrange for reduced payments while they try to sell the property. This is rife with problems, which the lenders recognise: sometimes the borrowers are not talking to each other, only one of them is in contact with the lending agency, the property cannot be sold fast enough to give people the clean break they want, or one partner refuses to sell, and it takes court action before it can be done. Stranraer CAB complain of the inflexibility of lenders. After a breakdown in a relationship, they argue, people often move into new locations or new patterns of income; people's ability to pay changes. They suggest that lenders should be ready to accept temporary reductions in payments, following up with periodic reviews of changes in circumstances, before they decide that a situation cannot be maintained.

Mortgage arrears

Most lenders are, in theory, sympathetic to people in debt. The Building Societies began as a co-operative, non-profit making system of mutual aid to help people buy their houses, and although many have abandoned the principles of mutuality in recent years, there is a long-standing tradition of trying to help people stay in their houses. The TSB - also, once upon a time, a mutualist organisation - writes to people in arrears:

> "We understand the difficulties a sharp reduction in income can cause, whatever your standard of living. We also understand that the circumstances may be outside your control. That is why we will do our best to help you through a difficult time. Remember that we do not want to repossess your home, that is always the very last resort, when all other attempts to reach an acceptable solution have failed."

Debt is not necessarily confined to the mortgage. Because people's homes are important to them, they will try to avoid missing payments; if they are struggling to meet the mortgage, there is a good chance they will also be struggling with electricity, gas bills and others. At the same time, the mortgage is often a very large bill relative to others, and people may miss it when they are able to meet others.

Contact

Most lenders contact people about debt very early on - usually after one payment has been missed. Contact is usually made by telephone or letter; telephone contact is often preferred. The approach at this stage is generally to try to make sure that the payment is made: the Halifax refer to this as the 'collection stage'. Following that, there may be a series of contacts, by phone or letter.

The central problem, from the lenders' point of view, is that many people do not respond. Dunfermline BS comments:

> "The principal problem faced by the Society in applying these procedures is establishing contact with the borrower. Unfortunately a borrower will often adopt a 'head in the sand' approach to the problem and will not speak to the Society."

Alliance and Leicester send a detailed letter, which tells borrowers:

> "we try to be flexible but we can only do this if you contact us to explain the circumstances so that we can discuss possible solutions with you."

The Halifax BS see the reluctance of borrowers to discuss issues as an indication of their fear of the consequences of admitting to problems:

> "Customers assume that because of their inability to pay the Society will commence action to obtain possession of their property."

Where people do not respond, lenders may arrange a visit - for which a charge is usually made to the customer. The Royal Bank of Scotland and the National and Provincial Building Society both charge £50. Clydesdale Bank took the strictest line.

> "If contact is ignored we would very quickly (say within 2 months) call up the debt, eventually evict and sell under our own hand."

The Bank of Scotland, similarly, would send a warning letter after two months arrears, and follow this up by a formal letter calling up the debt.

Most of the lenders, in their responses, emphasise the importance of a helpful approach, often based on some form of debt counselling. In the first instance, arrears are mainly followed up by local offices, but after a period a number of lenders will refer cases on to specialist units. National and Provincial pass arrears cases on to 'Customer Support'; Northern Rock uses a Regional Mortgage Counselling Centre.

Britannia's counsellors are 'proactive'; they discuss details of income and expenditure and help people to prioritise debts. The TSB has 'dedicated debt counsellors' (dedicated in the sense of having this as their main role, rather than of being self-sacrificing); the Nationwide has a 'dedicated business sector'. National and Provincial has a network of 'community counsellors' and a specialist team working on social security benefit issues. The main approach is to discuss income and expenditure, help people to prioritise debts, and come to some sort of arrangement which will make it possible for people to repay.

At the same time, the experience of people in arrears is often that they are subject to considerable pressure. While several lenders emphasise the importance of 'close monitoring' and the relative priority of the mortgage - one lender commented, 'they do not pay the catalogue before us!' Central Money Advice comments:

> "the attitude of the lenders is often unhelpful to both parties Excessive pressure is sometimes put on long-established customers with good payment records that are experiencing only temporary problems ".

Stranraer CAB felt that

> "over the last eighteen months/two years we have found lenders to be less willing to negotiate, ... their attitudes towards clients have also changed, from the almost paternal role to the lender /'naughty client' role."

Combined Community Projects in Kilmarnock observed that

> "the banks usually start off with a reasonable attitude but if the problems continue recovery methods will be severe."

There is a general problem that in any negotiation, the borrower will see the actions of the lender in the light of the sanctions which are open to them; they do not have to threaten or pressurise people for people to feel threatened or pressurised. The lenders try, in the first instance, to get people to pay, usually in the form of mortgage plus a proportion of the arrears. Glenrothes CAB comment that "the loan is secured on their house and this allows the lender to put exceptional pressure on to people who in the first instance will agree to any type of repayments." Under these circumstances, arrangements are liable to be broken. TSB comment:

> "Our experience is that many borrowers overestimate their ability to maintain an agreed repayments programme when they first encounter financial difficulties."

Arrangements to repay

"Lenders understand that some borrowers may, through no fault of their own, suddenly face a sharp reduction in income and will do their best to help borrowers through such a difficult time."[12] Lenders have a range of possible options. The Building Societies Association identify four: they can extend the loan term, reducing the payments due; accept interest only payments; change endowment mortgages into repayments mortgages; and point people towards advice and assistance. The Council for Mortgage Lenders adds three other options. Lenders can defer interest payments altogether for a period; they can capitalise the arrears, so that it gets added to the mortgage bill in the long term; and they can 'rescue' the mortgage by buying it out and renting the house to the occupant (which also means that the occupiers can become entitled to Housing Benefit, which is only available to tenants.)[13] The lenders differ in their approach: Dunfermline favour interest only or a reduced payment, Northern Rock suspend or reduce payments, TSB will extend the term, change the repayment method or suspend payments, and Britannia and the Woolwich will consider capitalising the debt. The National and Provincial and TSB publish leaflets about options for people in arrears.

One of the most dangerous traps for owner-occupiers in debt is the offer of a secured loan. A secured loan is, effectively, a second mortgage. It is a way of drawing on the capital value of a house, which is why borrowers in trouble may find it attractive, but it basically means that, if the loan is not paid according to the terms agreed, they will lose their home anyway. Glenrothes CAB observe:

> "people are apt to borrow in order to clear their feet with the preferential creditor and this can result in a downward spiral which may ultimately put them at even greater risk."

Secured loans are generally taken at a much higher rate of interest than the basic mortgage, with much more immediate penalty for default. Central Money Advice commented that

> "Some people are tempted to remortgage due to unscrupulous financers only bringing the debtor's notice to the immediate advantages, and glossing over long-term disadvantages such as the expense."

There is little question that arrangements with the first mortgage lender are clearly preferable; they cost less and they offer greater security. The problem is that people are often more afraid of the big lenders than they are of some of the sharks who are swimming close by.

Failure to comply with arrangements

Ultimately, failing to comply with arrangements leads to legal action. The general view put by the BSA is that

> "Building societies never like having to take possession of a property and fortunately there are very few cases where they need to do so. However, the borrower does contract with the society to repay the loan and if there is no prospect of repayments being made regularly the society really has no choice ..."[14]

That is not strictly true, as the section on arrangements for repayment makes clear; the lenders have a wide range of alternatives, and considerable powers to back themselves up. But it is generally true to say that building societies - unlike some finance houses and others who lend money against the security of people's houses - are reluctant to take possession of a property. Possession involves a fair amount of work for lenders, mainly undertaken to cut their losses. In most cases they are ready to give borrowers several months, and to negotiate at length, before seeking possession. Where this has ceased to be true, it is cause for comment: Glenrothes CAB note that the line in some cases has toughened, and "we are finding that many building societies are now foreclosing after only a few months arrears have elapsed".

In 1995, 1905 properties were taken into possession by mortgage lenders in Scotland, representing 0.22% of loans - less than half the rate which applies south of the border.[15] Possession does not necessarily involve court action. It can be done by agreement between the borrower and the lender - with the catch that the debt continues to grow until the property is actually sold - or by the borrower giving up the property altogether; [16] TSB note that for them, repossession usually happens only when the borrowers have actually abandoned the property. The Council for Mortgage Lenders estimate that only 40% of the cases of repossession go to court. When the property is repossessed, the lender has a duty to realise the best price, but not to wait for the best price: Kilmarnock CCP comment that in practice, "the house is often sold below market value and any equity due to the debtor will be lost."

There is a further consequence of repossession, which is that people are likely to find themselves on a blacklist for further credit. National and Provincial are explicit about this - to their credit, as their response relates to a general practice which there is too little information about. They have prepared a leaflet on repossession to explain to people just what is happening. The leaflet states:

> "As a member of the Council of Mortgage Lenders we are obliged to forward the names of any borrowers whose property is repossessed for inclusion on a central register with the credit referencing agencies."

This is one of the sources checked by agencies for any new mortgage.

The treatment of arrears: overview

Lenders and advice agencies have a very similar view of many of the problems which beset low-income owner-occupiers, and the difficulties they encounter when they are in debt. When it comes to the way the problems are dealt with, however, the pictures which emerge from their different perspectives are very different. The lenders tend to see their actions as sympathetic and ready to be flexible, but constrained by the practicalities. The advice agencies tend to see the lenders as rigid, insensitive to circumstances and driven by financial criteria. One of the advice agencies commented:

> "There seems to be a lack of consideration of individual circumstances. Lenders often do not look to the long-term which, in view of the fact that mortgages are long-term arrangements, seems short-sighted. In some situations this eventually backfires on the lender due to the detrimental effect on other areas of finance and stress."

There is, of course, some truth in both positions. The lenders do not always take advantage of the range of options which are open to them; they are liable to press people in difficulties into unrealistic arrangements, and then penalise them when they fail to meet those arrangements. At the same time, there are some notable examples of good practice; societies like the Britannia and the National and Provincial showed a clear understanding of the problems of poor people, and provided helpful information to try to overcome the problems, but like other lenders there are considerable difficulties in persuading their borrowers to trust them enough to make a practical arrangement possible before the situation deteriorates too far.

Recommendations

This report is a first attempt to put together information, and any recommendations have to be tentative. At the same time, the material in it clearly points to some problem areas which need attention.

Low income owner-occupation. The reasons why people want to become owner-occupiers are clear: owning property offers people considerable choice of affordable housing, independence and, relative to renting, a high degree of security. In an ideal world, people on low incomes would have the choice between good rented housing and good low-cost housing for purchase; that choice rarely, however, exists. Although some of the arrangements which are made clearly stretch the ability of borrowers to repay, it would not be desirable to make the conditions more restrictive, because to do so could make it still more difficult for people on low incomes to get access to decent housing. What is important for people in these circumstances is for them to be able to hold their commitments to a necessary minimum, and to safeguard their position, particularly in the event of falls in their income or future increases in interest rates. It would also be helpful for buyers to have more information about affordability in the broad sense, including potential repair costs and energy consumption; log books for housing could help towards this.

Mortgage purchase. Mortgages need to take into account people's ability to pay. The kinds of measures which are important are those which protect buyers from excessive costs and unnecessary commitments.

- The sale and advice of mortgages is insufficiently regulated, and buyers can be gulled all too easily. The Code of Mortgage Lending Practice is an important step forward by the lenders, but its operation will need to be rigorously monitored. There is still a case for regulation to protect the interests of consumers.
- Mortgages need to be as flexible as possible, particularly in the early years, to allow borrowers the opportunity to adjust their commitments to changes in their income. This could, and should, be built in to the design of mortgage policies.
- Mortgage protection policies need to be extended to cover the full range of circumstances. Lenders have the financial power to arrange this; borrowers do not.

Benefits. Several problems arise from the arcane rules which have been developed for the administration of benefits. It is not clear to people on benefits what is being paid for, when, or why. The payment period does not square with the periods over which people pay mortgages. Information is not shared between people who need to know it.

There are, however, more fundamental issues to consider. We have to ask whether we really think it is appropriate for people to lose their houses when they become unemployed. If not, we need a social security system that protects people against it.

There is a notable inequity in the position of owner-occupiers relative to tenants. People on low incomes who are tenants receive Housing Benefit; owner-occupiers in similar financial circumstances do not. Developing a Mortgage Benefit, or extending Housing Benefit to owner-occupiers, is something which Shelter has often argued for. This could also help to remove the anomalies which currently arise when people have to claim Income Support.

Relationship breakdown. The current arrangements are a mess, and it is difficult to see any clear way out of the problems. Lenders need to exercise a flexible approach, and should be prepared to accept temporary arrangements for limited periods; it would be appropriate for guidance to be prepared on handling the issues in this area. In the longer term, both the process of ending marriages, and the terms of mortgage contracts, need to be reviewed to ensure that the housing situation of people in relationship breakdown is adequately protected.

The practice of lenders Information about the policy of lenders is thin; we need to understand not just the general policy but how it is interpreted in practice, particularly where operations are decentralised. This research has thrown some light on formal policies, but financial institutions are encouraging local autonomy, in a situation where competition is fierce; a great deal more work is needed to understand local practice and how it varies.

Debt People in debt need advice. Many lenders have tried to offer advice in good faith, but the relationship between lenders and borrowers tends to vitiate the attempts. Independent advice is important; where there are no existing facilities, the responsibility mainly falls to local authorities to develop provision. Shelter would like to see an independent national body providing resources and guidance, and overseeing local centres.

Possession 1905 possessions is equivalent to about a third of the annual production of social housing for rent in Scotland; this cannot be an efficient use of social resources. There need to be legal avenues to ensure that the alternatives have been thoroughly investigated. The discretion of the courts in Scotland is very limited, by contrast with their powers in relation to tenancies. In England, courts are able, in cases where it can be shown that the arrears can be paid off over a reasonable period of time - usually, the period of the mortgage - to suspend the enforcement of a warrant of possession. The same power should be available in Scotland.

There also needs to be some consideration of possible alternatives to repossession, including mortgage rescue. This is one of the steps along the way towards flexible tenure, where people can convert from renting to owning and back again as circumstances change. Evaluation of existing initiatives should be undertaken, and further pilot studies developed, to establish the principle.

Information about owner-occupation. Existing information about owner-occupation in Scotland is not very full, and there are important gaps in the information, including information on the situation of home owners, the circumstances of people in arrears and the practice of lenders.

Notes

1. Scottish Office, 1996, Housing Statistical Bulletin Quarterly, HSG 1996/1.
2. Scottish Office, 1996.
3. Britannia Home Owners Confidence Monitor, Autumn 1995.
4. S Wilcox, 1994, Housing Finance Review 1994-95, York: Joseph Rowntree Foundation, p.145.
5. Wilcox, 1994, p.135.
6. Figures from Midland Bank, inclusive of MIRAS.
7. Council of Mortgage Lenders, 1996, Code of Mortgage Lending Practice.
8. Council of Mortgage Lenders, 1995, Handling of arrears and possessions - CML statement of practice, p.2.
9. Council of Mortgage Lenders, 1995.
10. T Levene, 1996, Mortgage rate trap for unwary, Scotland on Sunday 14th January.
11. Scottish Homes, Second Consumer Preference Study, p. 63.
12. Building Societies Association, 1985, Building societies and house purchase in Scotland, p.30.
13. Council of Mortgage Lenders, 1995.
14. Building Societies Association, 1985.
15. Adrian Coles, 1996, Speech to BSA/CML Committee for Scotland, Edinburgh 8th March.
16. Council of Mortgage Lenders, 1995.

This report was prepared for Shelter Scotland, under the guidance of Gavin Corbett. Shelter organised the distribution of the initial mailing.

The draft was read and commented on by Gavin Corbett, Ronnie Murphy and Derek Livingston; I am also grateful for the advice of Peter Robson.

Appendix: agencies responding to the enquiry

Abbey National
Alliance and Leicester Building Society
Bank of Scotland
Barclays Bank
Britannia Building Society
Clydesdale Bank
Co-operative Insurance
Dunfermline Building Society
Halifax Building Society
Midland Bank
National and Provincial Building Society
Nationwide Building Society
Northern Rock Building Society
Royal Bank of Scotland
Sun Banking Corporation
TSB Bank
Woolwich Building Society

Aberdeen CAB
Barra CAB
Bridgeton CAB
Easterhouse CAB
Central Money Advice Project, Falkirk
Citizens Rights Advice Service, Fraserburgh
Central Borders CAB, Galashiels
Fife Regional Council Trading Standards Department
Glenrothes CAB
Govan information centre
Combined Community Projects, Kilmarnock
Lewis CAB
Trading Standards Department, Lothian Regional Council
Stoneyburn Advice and Information Service
Stranraer CAB