CAB SUMMARY

evidence report findings

December 2007

Set up to fail

CAB clients' experience of mortgage and secured loan arrears problems

Citizens Advice Bureaux have seen increasing numbers of mortgage and secured loan arrears problems in the last two years. Homeowners in arrears receive little help from benefits, insurance or their lenders. Poor lending and arrears collection practices made problems much worse for many borrowers. Government policy and mortgage markets have paid too little attention to what happens when things go wrong. Consequently, too many borrowers are being set up to fail.

This report calls on government and regulators to take coordinated action to ensure that homeownership for lower income households is sustainable in the long term.

Background

Most people in the UK want to own their own homes and the Government wants to help more people become homeowners. Public policy on homeownership is currently geared towards encouraging more people to get on the housing ladder by tackling affordability, rather than the risks of not being able to pay the mortgage over the lifetime of the loan, particularly if circumstances change.

In the last year, Citizens Advice Bureaux dealt with over 57,000 problems about mortgage and secured loan arrears, an 11 per cent increase on the previous year. At the same time, the number of county court possession claims has increased sharply and is now at a similar level to that seen during the mortgage arrears crisis of the 1990's, even though the number of loans in serious arrears is much lower. This suggests that lenders are taking court action more readily and are less willing to help borrowers in arrears.

This report is based on 1,200 case studies from 360 Citizens Advice Bureaux in England, Wales and Northern Ireland, a survey of CAB clients with mortgage or secured loan arrears and interviews with CAB clients and advisers. We also analysed mortgage possession cases listed in 23 county courts in January 2007.

Main findings

Most CAB clients seeking advice on mortgage and secured loan arrears are disproportionately from lower income households. They tend to borrow from sub-prime lenders at a higher rate of interest.

In many cases, CAB clients do not shop around for a good deal. Instead they rely on the recommendations made by a broker. Often, they end up with inappropriate and unaffordable mortgages and secured loans. Some of the people buying their council homes receive particularly poor advice from brokers on the suitability of the loans they take out.

CAB evidence shows that many lenders and brokers do not ensure that borrowers understand the risks of entering into a mortgage. In some cases, it seems that lenders do not check whether the borrower can afford the mortgage repayments from the outset.

Some borrowers also take additional secured loans for items such as home improvements or debt consolidation. In some cases, these are as large as their main mortgage. Many do not realise the risks and consequences associated with taking out further secured loans.

Lenders' arrears management practices often increased the arrears problems borrowers face. They take court action for possession rather than negotiate with the borrower. Our research shows that sub-prime lenders are responsible for a level of possession actions substantially above their market share. Lenders have little incentive to consider alternatives to court action, and so can take possession action quickly, adding substantial additional costs to the borrowers' debt.

The growth of mortgage arrears problems has been accompanied by the development of sale and rent back schemes. In these schemes, the borrower sells their property to a private landlord at a discount and in return can rent the property back as a tenant. CAB evidence suggests that homeowners in a financially and emotionally vulnerable situation end up selling their houses for much less than they are worth, in return for a tenancy that offers little security of tenure.

Case 1

A CAB in Staffordshire reported that a man on a low income was struggling to pay both his mortgage of £474 a month and his credit card debts. A broker referred him to a sub-prime lender to remortgage his home. The new mortgage payments would be £640 per month at an interest rate of 10.45 per cent. After getting CAB advice on the implications of accepting the loan, he decided to refuse it. Instead the CAB negotiated repayments with his existing mortgage lender and credit card companies.

Case 2

A CAB in south east Wales reported that a couple with a disabled child were persuaded to take out a £50,000 second mortgage by a door-to-door salesman. The loan wiped out all the equity in the property, and increased their mortgage repayments to £1,300 per month. However the couple's total monthly income was only £1,500 per month. They could not afford the mortgage payments and soon fell into arrears.

Case 3

A CAB in Derbyshire saw a couple whose lender had taken them to court when they had two months arrears on their mortgage. Although they were paying the normal monthly mortgage repayment, they were unable to make a payment towards the arrears for three months whilst paying off council tax arrears. However, the lender proceeded to court action to repossess their home.

Safety nets are also failing. Take-up of mortgage payment protection insurance (MPPI) has declined. The Government's income support for mortgage interest payment scheme (ISMI) is also failing to keep CAB clients out of serious arrears problems, because of the limited help that it offers. Borrowers have to wait up to 39 weeks, because there is an assumption that MPPI will pay their mortgage during this period. After the waiting period, help is limited to a maximum mortgage size well below current average house prices and to a standard interest rate much lower than the sub-prime rates that many CAB clients have to pay. Furthermore, there is no equivalent of housing benefit to help homeowners in low paid work meet their housing costs, leading to hardship for some CAB clients.

The current system to protect consumers from unfair business practices in the mortgage and secured loan markets is not adequately dealing with the poor lending and arrears management practices outlined in this report. This is partly because two regulatory regimes apply. Whilst the Financial Services Authority (FSA) rules governing first charge mortgages are extensive, lenders are not always complying with them. Regulation of second charge lending by the Office of Fair Trading (OFT) has not been updated to take account of changes in the marketplace. The OFT also does not have a clear and proactive compliance strategy.

Our evidence suggests that sustainable homeownership is a challenge for many low income households. Better coordination of government policy and proactive regulation of bad businesses is needed to prevent these borrowers from being set up to fail.

Case 4

A CAB in Surrey saw a 38 year old man who had missed three mortgage payments when his business ran into difficulties. But he was able to restart his business and his wife had started her own business. They resumed mortgage repayments and were confident that they could pay off all the arrears in six months. In spite of this the lender took them to court for repossession.

Case 5

A London CAB reported that a woman in mortgage arrears was finding it very difficult to keep up with a court order to repay her mortgage arrears. After seeing an advert in the paper for a sale and rent back company, she agreed to sell her home to them without receiving any advice or comparative quotes. Her home was sold for £200,000, although it had been valued at £350,000. In return she received a six month assured shorthold tenancy at an initial rent of £750 per month. At the end of this period, the landlord put the rent up to £1,300 per month. The woman is now facing court action for rent arrears.

Case 6

A young widow with a baby sought advice from a Hampshire CAB about paying her mortgage. Her husband had committed suicide leaving her with a mortgage and no income. This meant that the life insurance cover they had was unlikely to pay out. Even if she claimed income support, the long wait for help with interest payments meant that she could lose her home.

Key recommendations

- **All secured lending should be included in a unified regulatory regime that takes the best from the existing regimes.**
- **In the meantime, the FSA and the OFT need to ensure that lenders treat borrowers fairly, both when making lending decisions and collecting and enforcing arrears.**
- **The Ministry of Justice should develop a pre-action protocol to ensure that mortgage and secured lenders take court action for possession only as a last resort.**
- **The Government's strategies for financial inclusion and financial capability should take into account the needs of low income homeowners.**
- **The Government should ensure that the help available from the benefit system fits the needs of people borrowing from sub-prime lenders at higher rates of interest.**
- **The Government should develop rules for the cost and quality of MPPI for all mortgages and secured loans.**
- **The Government should develop a benefit, comparable to housing benefit, for low income homeowners in work.**
- **The Government should act to protect people who enter into sale and rent back schemes.**
- **The Government should develop a cross-departmental action plan to address the issues raised in this report.**

The full report, Set up to fail, is available for £6.00 (including postage). To order a copy, please send your name and address, and a cheque made payable to Citizens Advice, to Citizens Advice, Myddelton House, 115-123 Pentonville Road, London, N1 9LZ.

Published by Citizens Advice, Myddelton House,
115-123 Pentonville Road, London, N1 9LZ.
Tel: 020 7833 2181
Fax: 020 7833 4371
www.citizensadvice.org.uk
Registered charity number: 279057
Citizens Advice is an operating name of
The National Association of Citizens Advice Bureaux