

Responding to the Mortgage Crisis

A Review of Recent Policy Announcements

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1 Introduction

- 1.1 The Centre for Economic & Social Inclusion is an independent, not for profit organisation working with national and local government, voluntary organisations and business to promote social justice and tackle disadvantage. We provide a wide range of services, including policy development, research and practice consultancy, in the fields of welfare to work, learning and skills, benefits and taxation, debt and poverty, housing and regeneration, equal opportunities, economic development and drugs, crime and criminal justice issues.
- 1.2 This paper is one of a short series of policy reviews provided to support discussions at the 'Responsible Credit 2008' conference taking place on 13th and 14th November at New Connaught Rooms, Covent Garden, London. The conference will bring together over 200 delegates from 25 countries to discuss the causes of the current global financial crisis and to discuss responses to it.
- 1.3 Other papers to be released in this series will focus on
- Over-indebtedness and the labour movement
 - Implications of the crisis for Corporate Social Responsibility
 - Building the Coalition for Responsible Credit
- 1.4 The conference will also discuss a draft declaration ('the London declaration') on the global financial crisis, which calls for governments throughout Europe to ensure consumer agencies and the labour movement are engaged in a constructive dialogue with the industry and government over future governance arrangements for the credit market. The full text of the draft London declaration is contained in the appendix to this report.
- 1.5 Further details of the conference, including booking arrangements and press passes can be obtained from Kylanda.chilcott@cesi.org.uk or on line at http://www.cesi.org.uk/events/current_events/responsible_credit_conference.htm

2. The UK Mortgage Crisis

- 2.1 The growth in mortgage repossessions in 2008 has been alarming. Over 79,000 mortgage possession actions were taken out by lenders in the first half of this year - a 17% increase on the same period in 2007. And more people are losing their homes than at any time since the last major housing market crash in 1991 and 1992. The total number of outright possession orders made by courts in the period July to September 2008 was 15,603. Back in the third quarter of 1991, the number of possession orders made peaked at just over 20,000¹.
- 2.2 The rapid growth in repossessions prompted government action on 2nd September and again on 23rd October.
- 2.3 On 2nd September, announcements were made which included
- A 'billion pound package for housing' from Department of Communities and Local Government, including the establishment of a £200 million mortgage rescue scheme to support 6,000 borrowers facing repossession
 - DWP proposed reform of Income Support Mortgage Interest payment rules to be implemented from April 2009 – which will reduce the waiting time before claimants become eligible for support with mortgage payments from 30 weeks to 13 weeks and raise the limit on house values covered by the scheme to £175,000
- 2.4 On 22nd October, the Prime Minister, Gordon Brown, stated that government was “determined to do everything we can to help homeowners avoid repossessions” and announced details of “new guidance for the judiciary to halt or adjourn court action on repossessions, unless alternative options that help the homeowner ... have been fully examined”². This referred to a ‘pre-action protocol’ to be followed

¹ All figures cited from data published by the Council of Mortgage Lenders, downloaded from <http://www.cml.org.uk/cml/statistics> on 1/11/08

² “Brown pledges action to curb home repossessions”, Patrick Wintour, The Guardian 23/10/08; “A matter of protocol”, Richard Alcock, The Guardian Money Blog, <http://www.guardian.co.uk/money/blog/2008/oct/24/repossessions-mortgages>, retrieved 1/11/08

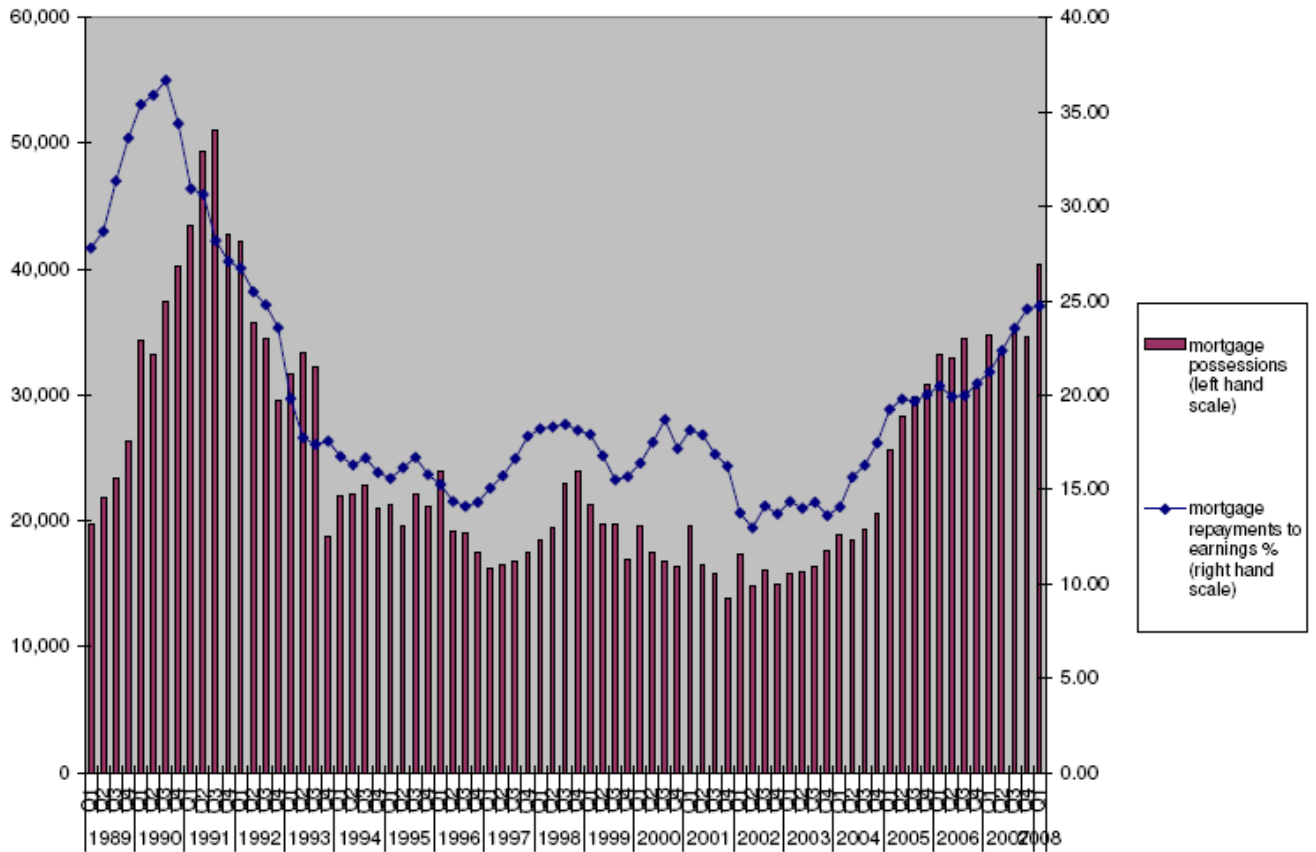
by lenders prior to instigating repossession proceedings which was issued the same day by the Civil Justice Council. Also released the same day was industry guidance from the Council of Mortgage Lenders which provides further details of the alternative options to be considered. Further details of both of these can be found in section 4, below.

- 2.5 However, our analysis of the factors which lie behind the rise in repossessions indicates that the policies so far set out by government are unlikely to be effective in reversing the rising tide of repossessions.
- 2.6 In the main, this is due to the fact that there has been an inadequate focus on mortgage *affordability*, which we believe is now the key problem that has to be addressed. The 'pre-action protocol' provides courts with no additional powers to insist, for example, on the modification of loan agreements during repossession proceedings, and the mortgage rescue fund announced by DCLG is expected to help only 6,000 borrowers - with assistance conditional on the borrower giving up a share of the property. The UK's approach contrasts with the development of 'loan modification programmes' and proposals to introduce an 'affordable housing tax credit' in the U.S, from which lessons urgently need to be learnt.
- 2.7 In this paper we argue that responses from government should focus on restoring mortgage affordability and providing greater protection to those borrowers who need help to reschedule their mortgage payments over the long term as a result of negative equity. In the light of the recent rapid rise in unemployment, more help will also need to be targeted at households where one member of a couple loses their job.

The Importance of Affordability

- 2.8 Mortgages have been getting less affordable in the UK since 2004. According to the Halifax, mortgage repayments now equate to over 25% of average full time male earnings. Our analysis indicates that this increase in the cost of borrowing relative to earnings is the main driver behind mortgage repossessions.

Chart 1: Cross reference of Mortgage Possession Actions and Affordability Ratio



Sources: Halifax House Price Index and Council of Mortgage Lenders

2.9 As can be seen from the chart, periods of growth in mortgage repossession activity are closely linked to reductions in the affordability of mortgages. It should be noted that the Halifax uses *average* mortgage repayments and full time male earnings to construct its ratio. There will therefore be households who pay significantly more than 25% of earnings, and households which pay significantly less than this figure. Those households paying significantly more will include the estimated 8% of borrowers with sub-prime mortgages in the UK.

2.10 There are, of course, limitations in using the ratio of mortgage repayments to average male full-time earnings as a measure of affordability, and we have done so here only because this is the most recently available source of information. DCLG releases data concerning household expenditure on housing costs, broken down by types of housing tenure, which provides a better indication of

overall shifts in affordability. However, the most recent dataset available is for the year 2006/07.

- 2.11 Nevertheless, the DCLG data, which includes Council Tax as well as mortgage payments, confirms the overall picture. Between 2002/03 and 2006/07, households with mortgages increased their expenditure on housing costs as a % of their disposable income by an average of 6% (from 23% to 29%). The number of households paying out in excess of 30% of their disposable income on housing costs also increased significantly over this period (2.8 million households in 02/03 to over 4 million households in 06/07)³.
- 2.12 Unfortunately, the DCLG data does not provide any further breakdown of household expenditure on housing costs beyond 30%. Although not directly comparable with the DCLG data, the Bank of England's annual NMG survey provides further evidence of the problem. This reveals that, at the time of the survey (September 2007), 12.5% of mortgagors had paid 35% or more of their income in the previous month on secured debt repayments, and 6% had spent more than 50% of their income in this way.
- 2.13 The link between mortgage repossessions and affordability appears strong, but there are a number of time lags and other factors which need to be accounted for.
- 2.14 Firstly, the nature of the mortgage product has a bearing on the point at which reductions in overall affordability impact on individual households. Borrowers with fixed rate products are shielded for a periods but can find themselves facing a payment hike when fixed rate periods come to an end.
- 2.15 Secondly, having the ability to reschedule mortgages by accessing new mortgage credit becomes extremely important to those borrowers coming off fixed rate mortgages, or otherwise facing problems with the levels of repayment for example as a result of reduced income. Unaffordable loans can be turned into affordable ones if arrears are capitalised and the loan term extended, but this requires access to mortgage credit to achieve.

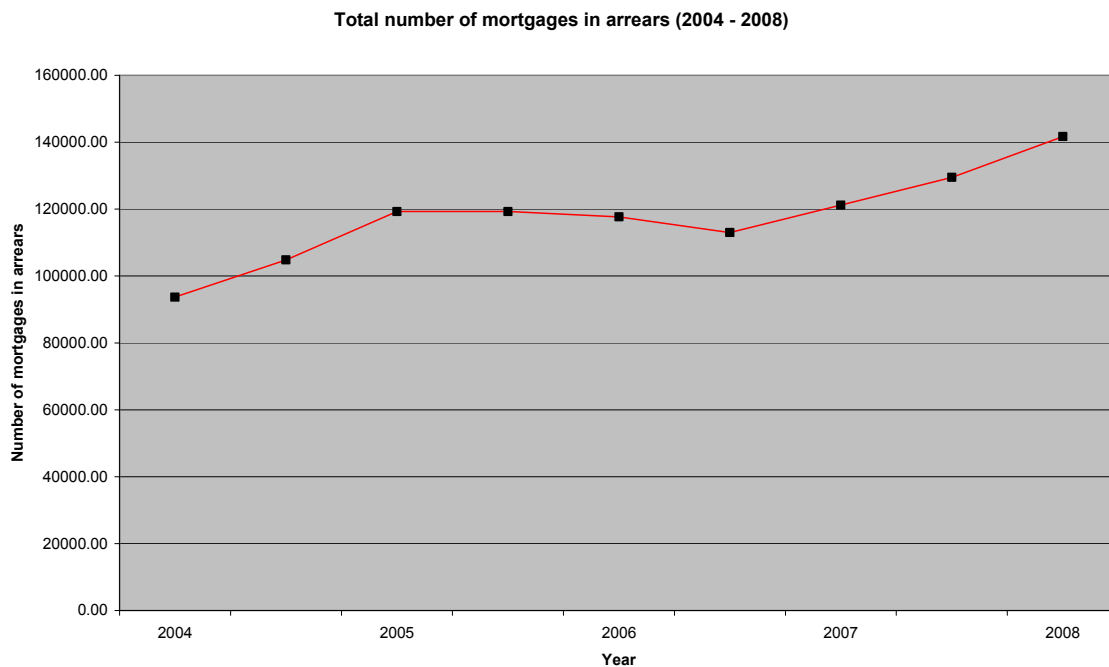
³ Data retrieved from <http://www.communities.gov.uk/documents/housing/xls/141533.xls> on 1/11/08

- 2.16 Thirdly, affordability of mortgage repayments can be supported by tax breaks or other government measures. In the 1980's and 1990's mortgage borrowers benefitted from Mortgage Interest Relief At Source ('MIRAS'), which provided for tax relief on the first £30,000 of qualifying mortgages for single borrowers and up to £60,000 for couples. In 1991/92, expenditure on MIRAS amounted to over £7 billion per year and reduced mortgage payments by an average of £150 per year⁴. MIRAS was phased out and finally abolished in the UK in 2000. Other countries, including Ireland, maintain similar schemes, and U.S presidential candidate, Barack Obama, has set out a proposal to ensure that a 10% tax break on mortgage interest payments to all homeowners in the states, labelled as a 'Universal Mortgage Credit', in his economic manifesto. If introduced, this is expected to be worth \$500 per year for mortgage borrowers in the states.
- 2.17 Finally, legal protections and court processes governing repossession proceedings are important. Legal rights form the context in which negotiations over level of repayments of arrears take place and 'frame' the attitudes of lenders and borrowers in these negotiations. There was considerable confusion concerning court powers in the 1990's regarding the period over which judges could order arrears to be repaid, which was only clarified by case-law in 1996⁵. As a result, many people were unaware of the powers of the court to assist them and did not always contest proceedings.
- 2.18 It is important to note that the recent reduction in mortgage affordability in the U.K has not been caused by high central bank base rates as was the case in the late 1980's and throughout the 1990's. The UK has witnessed low base rates by comparison in the current decade. The reduction in affordability has instead been caused by rising house prices which have required greater levels of mortgage borrowing. This has made households much more *sensitive* to mortgage rate increases than was the case in the past as there is a greater level of outstanding debt on which any increase has an impact. This sensitivity is particularly acute for borrowers who do not have the protection of fixed rate mortgage products or at points at which those fixed rates come to an end and household budgets need to adjust to new rates.

⁴ Figures from HM Revenues and Customs, <http://www.hmrc.gov.uk/stats/mir/menu.htm>, retrieved 2/11/08

⁵ *Cheltenham & Gloucester B.S. v Norgan* [1996] 1 WLR 343, CA.

2.19 That sensitivity of households to mortgage rate increases has now been demonstrated by the alarming speed with which the global financial crisis has resulted in increased mortgage repossessions. As banks constrained their lending to each other, mortgage rates paid by borrowers 'de-coupled' from the base rates set by central banks, and household budgets already stretched by rising food and fuel prices have buckled under the strain. Unable to reschedule mortgages over longer periods due to the reduced supply of credit, a surge in the number of mortgages in arrears has resulted (51% increase since 2004).



Source: Council of Mortgage Lenders data, Inclusion analysis

Restoring Mortgage Affordability: The Problem

2.20 We consider it is now essential to reduce the cost of mortgages if a huge growth in repossessions is to be avoided. The traditional method to achieve this would be through cuts to central bank base rates. However, because mortgage rates have been de-coupled from policy rates, this policy lever is likely to have less impact. As a result there have been calls from some quarters for 'aggressive' base rate cuts – on the basis that it will take deeper base rate cuts than

previously in order to achieve the desired reductions in mortgage rates⁶. Large base rate cuts may yet take place⁷, but these are likely to prove too late to save many borrowers from repossession.

2.21 The most recent Financial Stability Report from the Bank of England indicates that the re-coupling of mortgage rates to base rates will not be immediate, even following the recent steps to recapitalise British banks. At present, the 3 month LIBOR rate, which better determines the mortgage rates available to borrowers, stands over 200 basis points (2%) higher than the base rate. Even by the Bank's most optimistic forecasts the spread between the LIBOR rate and the base rate is not expected to return to normal levels until March/ April 2009⁸. On current trends, that period of time will see a further 80,000 applications for repossession orders, and nearly 30,000 more households will lose their homes.

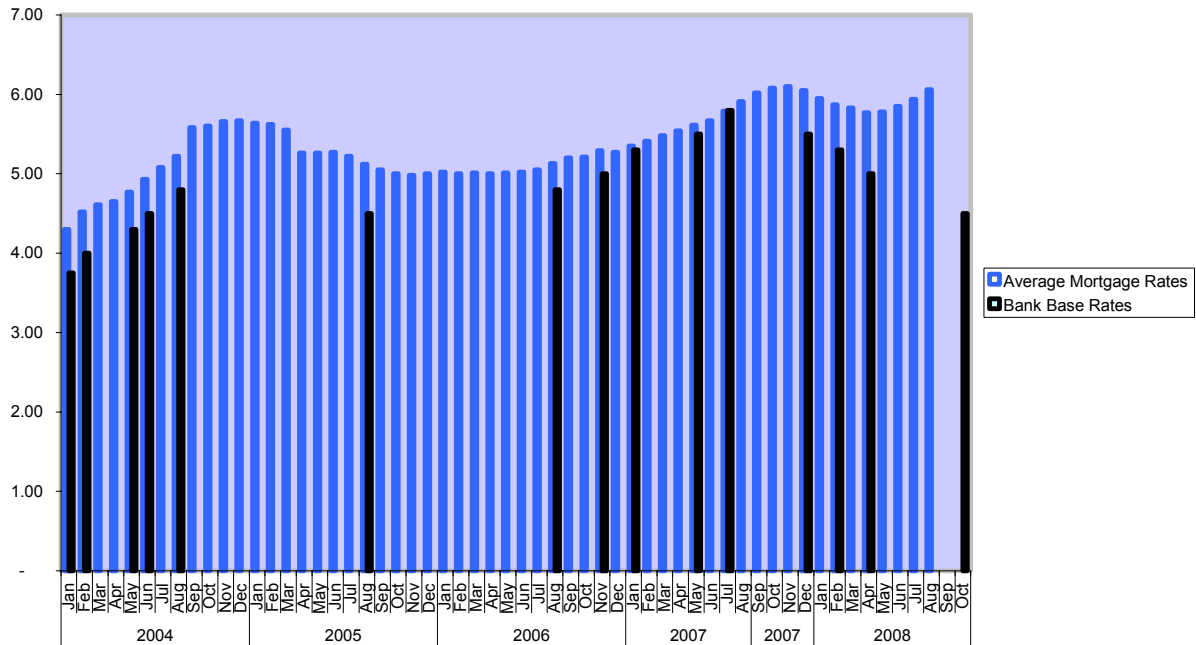
2.22 The chart on the following page demonstrates the degree to which de-coupling of mortgage rates from central bank base rates has occurred in the past few months in comparison with the period since January 2004. It plots Council of Mortgage Lender data on the average mortgage rate charged to borrowers across all types of mortgages between January 2004 and August 2008 together with Bank of England base rates over this period. As can be seen, the next set of data from the Council of Mortgage Lenders, due to be released on 11th November, concerning actual mortgage rates available to borrowers will be critical.

⁶ For example, MPC member David Blanchflower, see "Lending window is shut but rate cuts will help", David Smith, Sunday Times, 2/11/08

⁷ As at the time of writing, it is expected that the Monetary Policy Committee of the Bank of England will reduce interest rates by a full percentage point at its next meeting on 5th and 6th November.

⁸ Financial Stability Report, Bank of England, October 2008, pg. 35. However, it should be noted that some standard variable rates (SVR) could be higher still. According to The Guardian, 1/11/08, Halifax recently changed terms and conditions to allow it to charge up to 3% more than the policy rate to customers on its SVR

Average Mortgage and Base Rate Changes



2.23 It should be noted that if re-coupling does not take place then even aggressive cuts to the base rate may not prove adequate to significantly bring down the cost of borrowing for many households. At that point, central banks may need to take more direct control over the setting of mortgage rates if repossessions are to be prevented from accelerating further.

2.24 Even in the event that there is a *general* re-coupling of mortgage rates with base rates, this will not be enough to save higher risk borrowers from experiencing further increases in the costs of their mortgages. For those with high loan to value ratios the Bank of England has warned that access might only be available to standard variable rates. The Bank considers that in these cases borrowers are likely to face increases in mortgage rates of approximately 2%⁹.

2.25 Many mortgage products are also structured in ways that could prevent full base rate reductions from being passed onto borrowers. As the Guardian reports

“...several lenders have ‘collars’ in place [to tracker mortgages] that mean some customers could lose out...Nationwide...customers interest rates can’t go below

⁹ Financial Stability Report, Bank of England, October 2008, pg. 10 - 11

2.75%, irrespective of what happens to base rates. Halifax has an option not to pass on rate cuts below 3%...HSBC...will interpret its terms as market conditions emerge.”

“Beware the lenders’ get-out clause from base rate cuts”, The Guardian, 1/11/08

- 2.26 In the event that base rates do go below 3%, then government action may also be required to force lenders to restructure these mortgages and to reduce borrowing costs for households.

Vulnerable Borrowers Face a Vicious Circle

- 2.27 Secondly, even if mortgage rates now start to reduce, it is inevitable that the fall in house values will make it difficult for some homeowners to re-mortgage. Approximately one in ten of all households with a mortgage, 1.2 million in total, are estimated to be at risk of falling into negative equity if house prices fall by 15% this year¹⁰. These households do not make an attractive proposition for re-financing under commercial conditions.
- 2.28 These households are at particular risk because there is an incentive for lenders to speed up repossession activity in this climate. Faced with rapidly devaluing assets on which their loans are based, lenders will attempt to mitigate losses by realising those assets as quickly as possible before values fall further. Anecdotal evidence from debt advice agencies confirms that this dynamic is already in play¹¹.
- 2.29 Whilst the collective result of lenders rushing towards repossession will lead to a further devaluation of assets (as the supply of properties in the market increases and demand weakens), such action makes sense to individual lenders because they cannot trust their competitors to refrain from acting in this way and need to move to protect their own interests. Their responsibility is to shareholders in the short term.
- 2.30 As such, lenders are currently caught in a ‘prisoner’s dilemma’ whereby perfectly rational individual behaviour on their part only worsens the collective problem of

¹⁰ Financial Stability Report, Bank of England, October 2008, pg. 10

¹¹ “Lenders rushing to seek repossessions”, Patrick Collinson, The Guardian, 1/11/08

rapidly reducing house values. A vicious circle of repossessions, causing greater falls in house values, increasing further the numbers of households in negative equity, and feeding back into yet more repossession, quickly results.

- 2.31 This requires decisive action from government to resolve. It will itself, of course, be a major player in the UK's mortgage market with the creation of UK Financial Investments Ltd ('UKFI') which will oversee how the £37 billion of taxpayers funding for banks will be used. UKFI is also expected to take control of the former Northern Rock and Bradford and Bingley operations.
- 2.32 As part of the announcement concerning UKFI made on 4th November, the Treasury is reported as confirming UKFI's role as "maintaining, over the next three years, the availability and active marketing of competitively priced lending to homeowners and small businesses at 2007 levels¹²".
- 2.33 In the next section, we put the case for the government to learn lessons from the U.S and to use its new influence in the mortgage market to charge UKFI with a responsibility to ensure greater mortgage affordability and to implement loan modification programmes to help stem the tide of repossessions.

¹² "Treasury moves to protect taxpayer funds", Phillip Inman, The Guardian, 4/11/08

3. The Need for ‘Mortgage Restructuring’

- 3.1 The likely delay in restoring mortgage affordability, which is contingent on ‘re-coupling’ mortgage and policy rates, and the fact that even if mortgage costs are reduced there will be an estimated 1.2 million borrowers in negative equity which will find it difficult to avoid repossession proceedings, support the argument for the introduction of major mortgage restructuring programmes.
- 3.2 These should be modelled on the ‘loan modification’ programmes currently being implemented in the U.S, which allow borrowers to replace existing high cost variable and short term mortgages with longer term, fixed rate, and affordable borrowing. They serve not only to protect the individual households concerned, but also to place a floor under the housing market as a whole and can help to restore confidence to the market. They can start a virtuous circle whereby restructuring mortgages cuts repossession rates, which in turn helps stem the fall in house values. This promotes inter-bank lending which helps to re-couple mortgage rates to base rates, and which reduces the cost of mortgages. Greater affordability results in less mortgage arrears and less repossessions.
- 3.3 Sheila Bair, Chair of the U.S Federal Deposit Insurance Corporation (‘FDIC’), the body which took over failed bank IndyMac earlier this year, has been at the forefront of developing loan modification programmes in the states. The FDIC has now implemented a programme to reduce former IndyMac borrowers repayments to no more than 38% of total household income.

“A clear consensus is emerging that broad-based and systematic loan modifications are the best way to maximize the value of mortgages while preserving homeownership — which will ultimately help stabilize home prices and the broader economy”

Sheila Bair, quoted in “Banks alter loan terms to head off foreclosures”, New York Times, 31/10/08

- 3.4 Bank of America has followed suit following court action against it by representatives of sub-prime borrowers by announcing a \$8.4 billion programme to help up to 400,000 households that took out sub-prime loans prior to

- December 2007. Repossession actions have been halted pending a systematic process of offering new loans to these customers which will limit payments to 34% of borrower's income in the first year of the new agreements.
- 3.5 The concept is spreading quickly. Only last week, J.P Morgan Chase also announced a major initiative to modify mortgages. The details involve placing a moratorium on repossession action for 90 days whilst it offers new affordable fixed rate 30 year mortgages to borrowers currently on high cost adjustable rate products. The plan also involves offering borrowers the opportunity to pay interest only for 10 years and to defer capital repayments for a period or until the house is sold.
- 3.6 Actions so far announced to help hard pressed mortgage borrowers in the U.K are pale in comparison. The DCLG funding for mortgage rescue schemes announced in September aims to help only 6,000 borrowers (which is only 4% of the total number of mortgages that are currently in arrears) and the scheme appears likely to suffer from overly complex administrative arrangements with a range of agencies involved in its implementation. It is also notable that the UK mortgage rescue scheme relies upon borrowers agreeing to give up a share of their properties to registered social landlords.
- 3.7 Equally, there is growing criticism of the arrears handling and repossession policies of Northern Rock, which is under government ownership. In October this year it was revealed that the number of properties repossessed by Northern Rock had increased by nearly doubled on the previous year (4,201 to 2,215)¹³. Whilst Northern Rock responded to the criticism by stating that it only used repossession as a 'last resort' it is clear that no plans have yet been developed to support large scale mortgage restructuring of the type being implemented by the FDIC in the U.S.
- 3.8 If government is to protect mortgage borrowers, particularly those who are already falling into negative equity as a result of the dramatic reductions in house prices, then the loan modification programmes currently being put in place in the U.S form a useful model on which UKFI could build.

¹³ "Anger over Rock repossession rate", 17/10/08, BBC News, retrieved from http://news.bbc.co.uk/1/hi/uk_politics/7676671.stm on 2/11/08

- 3.9 Whether or not the funding to support mortgage restructuring programmes is to come from the taxpayer – perhaps as part of the existing £37 billion of investment that has so far been made to the banks – or whether this can be supported through the use of bank funds or a combination of the two, will need to be worked through in more detail. However, it is urgent that these discussions now take place and that an agreed package is stitched together between UKFI, HM Treasury, the Bank of England and mortgage lenders.
- 3.10 Finally, as we argue in the following section, the definition of what constitutes the ‘last resort’ needs to be reviewed in the U.K. The details of the ‘pre-action protocol’ for repossession action announced last month and the industry guidance do not extend lender’s responsibilities significantly to avoid taking out repossession proceedings. A lender faced with a borrower in arrears who cannot afford the contractual payments on their mortgage is not required to consider modifying a mortgage agreement prior to repossessing a property, and the courts have been granted no additional powers to require this.

4. Legal Protection for Borrowers Needs Improving

- 4.1 The legislation governing county court powers to prevent repossession is primarily contained in S.36 of the Administration of Justice Acts 1970 and S. 8 of the Administration of Justice Act 1973. These sections have, over the years, been the subject of much case-law which has clarified their interpretation.
- 4.2 In brief, the main powers of county court judges under these Acts consist of suspending repossession of a home where there is evidence that the borrower will be able to repay the mortgage plus any arrears within a 'reasonable period'. With the increase in mortgage repossession proceedings in the late 1980's and early 1990's the definition of 'reasonable period' became critical with many judges indicating that payments could be extended over the entire length of the remaining period of the mortgage in order to help borrowers, whilst others took a harsher line and insisted on repayment of arrears over shorter periods.
- 4.3 The Cheltenham and Gloucester v Norgan¹⁴ case finally decided the matter in 1996, and found that it was legitimate for judges to interpret a reasonable period as the entire length of the remaining mortgage period. However, this means only that a borrower must be able to demonstrate that they can make the contractually required payments plus clear any arrears within the mortgage period. It therefore still requires borrowers to make their normal payments plus an additional amount, however small, towards the arrears. Critically, there is no power for the court to re-write the mortgage agreement, for example by capitalising the arrears and extending the mortgage term, or by insisting on a reduction in the rate of interest that can be charged.
- 4.4 Given the limitations of court powers in this respect, much therefore rests on what government and lenders mean when referring to repossession as a 'last resort'. The pre-action protocol issued by the Civil Justice Council on 21st October and the new industry guidance from the Council of Mortgage Lenders of the same day set this out.

¹⁴ See previous citation, footnote 5

4.5 The pre-action protocol ‘describes the behaviour’ that the court normally requires from lenders prior to the instigation of repossession proceedings. It is not legally binding but seeks to ensure that lenders and borrowers act ‘fairly and reasonably’ towards each other to try and resolve problems. It also aims to promote dialogue between lenders and borrowers prior to repossession proceedings being brought.

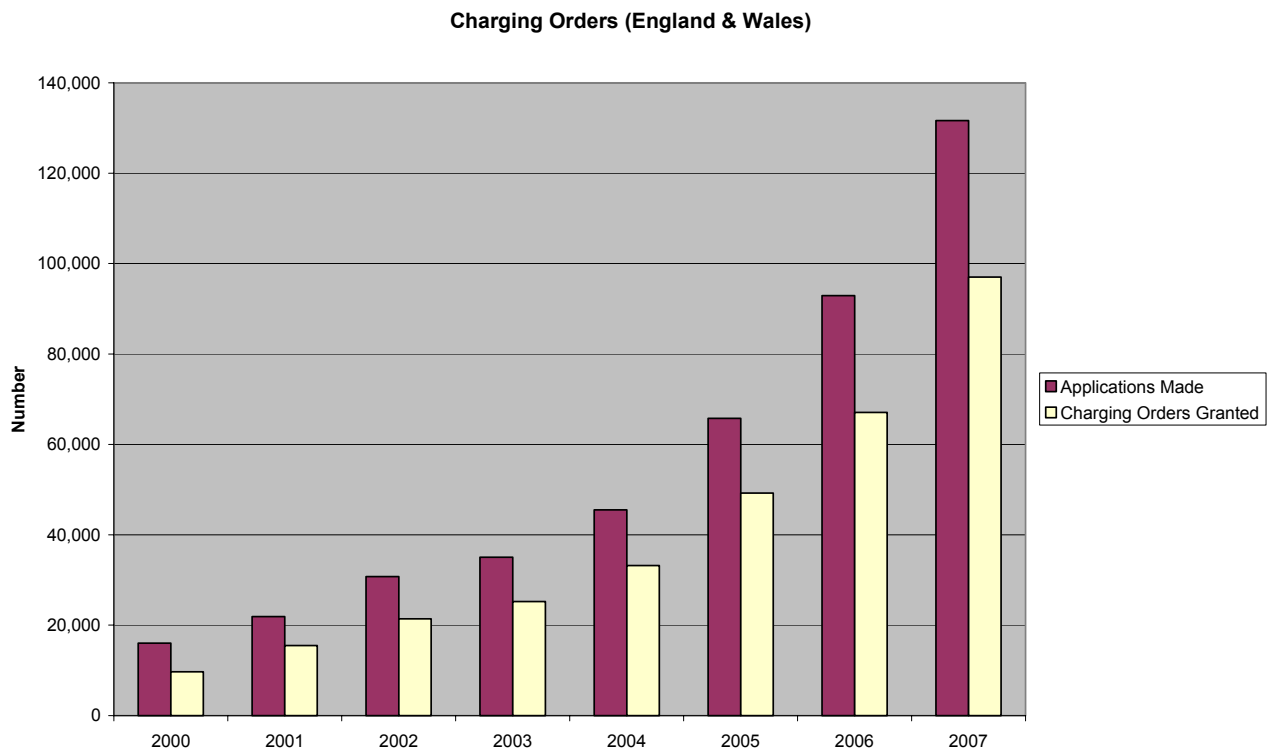
4.6 The pre-action protocol applies not only to mortgages but also to secured loans or second charges. However, it does not apply to consumer credit loans which can become secured on homes later through the use of ‘Charging Orders’ (see para 4.13 below).

4.7 The features of the pre-action protocol are set out in the table, below.

Initial Contact	<ul style="list-style-type: none"> • Lenders should provide regulatory information sheets or the National Homelessness Advisory Service booklet on mortgage arrears • Information sheets should detail the amount of the arrears, amount of mortgage outstanding, and details of interest and charges
Lender obligations	<ul style="list-style-type: none"> • Discuss the cause of the arrears, the borrower’s financial circumstances, and proposals for repayment. Consider whether or not the borrower will be able to repay the arrears in a ‘reasonable’ time Advise borrowers to contact Local Authority Housing Departments and should ‘where necessary’ refer the borrower to debt advice agencies • Consider ‘reasonable requests’ to change the payment date or payment methods • Respond promptly to any proposals for payment and should give reasons for any rejection within 10 days • Give 15 days notice of any intention to start repossession action • Shouldn’t start repossession action if there is an insurance claim outstanding which could cover the mortgage repayments • Consider postponing repossession action if borrower has started to sell. Supporting information demonstrating this needs to be provided to the lender. • Consider postponing repossession action if the borrower has complained about the lender to the Financial Services Ombudsman
‘May’ consider	<ul style="list-style-type: none"> • Extending the term of the mortgage • Changing the type of the mortgage • Deferring interest payments that are due • Capitalising the arrears

- 4.8 As can be seen from the above, the pre-action protocol does not require lenders to consider loan modification and is still very much 'framed' by the current legal requirements to demonstrate that arrears can be repaid over a 'reasonable' period. As considerable discretion still rests with the lender it is hard to see how the protocol will significantly impact on lender behaviour when balancing the needs of borrowers with their obligations to mitigate losses to shareholders.
- 4.9 The Council of Mortgage Lenders industry guidance takes the form of a 'good practice' guide separating out its advice into what 'must' and what 'may' be included in repossession and arrears management policies and procedures.
- 4.10 Actions which the Council of Mortgage Lenders state 'must' happen, beyond those included explicitly referenced in the pre-action protocol, include
- Contacting customer immediately when payments have been missed
 - Explaining the options for repaying shortfalls in writing and invite customers to phone for a discussion
 - Providing arrears staff with flexibility to negotiate repayment agreements, and refrain from starting possession proceedings until senior managers have confirmed that a repayment proposal is not likely to succeed
 - Being flexible over the length of time for repayment bearing in mind case-law states that a reasonable period may be the remaining length of the mortgage
 - Not taking court action where a reasonable negotiated settlement is possible or as a measure to discipline customers into keeping to agreements to repay arrears
- 4.11 However, it goes no further than the pre-action protocol when it confirms that a lender may modify the loan agreement in order to assist borrowers, but is not required to do consider this.
- 4.12 Despite the publication of the pre-action protocol and the CML guidance there has been no significant increase in the level of protection that borrowers receive when it comes to repossession proceedings. In particular, it is likely that they will still need to demonstrate an ability to repay the arrears in order to achieve a postponement of legal proceedings.

4.13 In addition, the pre-action protocol and industry guidance do not cover the use of Charging Orders, which can be obtained by unsecured consumer credit lenders to secure loans on homes as a means of enforcement. Changes contained in the Tribunals, Courts and Enforcement Act, 2007 have made these easier to obtain¹⁵.



4.14 The increased use of Charging Orders as a means of enforcement by consumer credit lenders poses considerable risks for homeowners. Faced with the need to pay mortgages and to repay any mortgage arrears as a priority, many borrowers will need to either reschedule or default on unsecured borrowing. However, there is an obvious danger that this itself lead to action through the use of Charging Orders to force the sale of homes. At the present time, the Ministry of Justice does not publish statistics on the numbers of orders for sale that result from consumer credit debts, so it is not possible to report further on the degree to which this is occurring. Up to 100,000 households may currently be at risk of losing their homes as a result of Charging Orders.

¹⁵ S. 93, Tribunal, Courts and Enforcement Act, 2007 removes the requirement for debtors to be in default with the terms of a county court judgment prior to a charging order being issued.

5. Conclusion and Recommendations

- 5.1 Mortgage repossessions are rising rapidly. Our review of recent policy announcements indicates that these will be unlikely to be adequate to stem this tide. There has been an inadequate focus on the links between mortgage affordability and repossession rates, and legal protection for borrowers in arrears remain weak – contingent on borrowers being able to make continued contractual payments and to make additional payments towards any accrued arrears.
- 5.2 We estimate that, on current trends, at least 30,000 people could lose their homes within the next six months. This figure could grow further if house values continue to fall and measures are not introduced to prevent repossession action by lenders.
- 5.3 Although base rate cuts may help to make mortgages more affordable in the longer term, the ‘de-coupling’ of mortgage rates from base rates indicates that even aggressive reductions in the base rate will not translate into greater affordability of mortgages until at least March 2009.
- 5.4 In view of this, government will need to use additional policy levers to help households experiencing financial difficulties.
- 5.5 To make mortgages more affordable government should consider introducing a form of mortgage interest relief for low income households. Possible options include reinstating a universal MIRAS system or using the existing tax credit regime to provide more targeted assistance to low income households.
- 5.6 Using the tax credit system to channel additional support for mortgage interest payments to those who need it most would also add in protection for those households which will be ineligible for Income Support Mortgage Interest payments, which are contingent on all members of the household being out of work.
- 5.7 For those mortgage borrowers with the greatest difficulty in paying their mortgages, particularly those who are required to pay in excess of one third of

their income on secured debt repayments, government should seek to ensure that mortgage restructuring programmes are put in place by lenders to reschedule these agreements over longer term periods and to reduce monthly repayments.

- 5.8 Government should take the lead. Its control over Northern Rock, the former Bradford and Bingley and its holdings in other banks which are now managed by UKFI provides it with the necessary means to insist on the development of mortgage restructuring programmes. It can prevent the tide of repossessions from rising further and has already provided banks with a huge investment of funds which could be used to achieve this.
- 5.9 To ensure that borrowers receive all the assistance possible prior to repossession, government should also look to strengthen the level of protection offered by the courts. Two specific measures would help. Firstly, the government should urgently amend S. 36 of the Administration of Justice Act, 1970 to provide for county court judges to be able to amend the terms and conditions of mortgage agreements in order to reduce the interest rate, extend the term, and to capitalise arrears, it appears just for them to do so. In effect, this would give judges the right to restructure mortgages themselves. Secondly, protections against the use of Charging Orders should be introduced to ensure that mortgage payments are not jeopardised by consumer debt enforcement.
- 5.10 Finally, government, the Bank of England, and UKFI should set out transparent targets for future mortgage repayment affordability as part of their economic objectives and plans and their priorities for the use of taxpayer investment in the financial services industry. In order to monitor progress towards these the level of reported data on mortgage affordability will also need to be improved.

Appendix:

Draft London Declaration on the Global Credit Crisis for discussion on 13th November

We, the European Coalition for Responsible Credit and Debt on our Doorstep, with the support of our partners around the globe, call on our governments, financial regulators, and central banks, to take immediate action to support households in financial problems and to work with us and other consumer agencies, academics, and the labour movement to establish new rules for the regulation of credit markets at the international, European, and national levels.

The current crisis is a product of the long term neglect of consumer interests in the credit markets and inadequate regulation of the financial services industry. Over the past twenty years we have witnessed the continued weakening of consumer protections in the name of supporting free and efficient markets. The failure of this approach in the credit market is now self evident. This is not a crisis born from providing access to credit to low income groups, but one caused by providing them only with *irresponsible* credit products and failing to protect their long term interests in the market.

We call on all governments across Europe to

1. **Improve help available to households in mortgage arrears, by**
 - a. Establishing, with the financial services industry, a 'mortgage rescue fund' for households which can be used to help borrowers reschedule mortgages at affordable rates of interest over the next five to ten years
 - b. Providing courts with the power to halt the repossession of homes and to reschedule mortgages by accessing the 'mortgage rescue fund'

2. **Enhance court protection for borrowers with unsecured debts, by**
 - a. Providing for borrowers to obtain, on their own application, a temporary moratorium on recovery action for up to one year, subject to judicial discretion
 - b. Preventing unsecured lenders from obtaining legal charges on homes

3. **Ensure adequate provision of debt advice services**, by developing and implementing, with the active involvement of consumer agencies, a national debt advice plan. The plan should be developed following the commissioning of independent research into the demand for, and supply of, debt advice provision and current funding levels for advice services.
4. **Include a duty in bank and credit licenses obliging lenders to ensure people on lower incomes have access to responsible credit products**, and which requires lenders to report in a standardised and public way on their performance in meeting this obligation
5. **Build and monitor a new regulatory framework with active consumer involvement** by
 - a. Ensuring consumer agencies are represented on key policy making and supervisory bodies at the global, European, and national levels
 - b. Providing financial support to enable consumer agencies to participate in an ongoing dialogue with regulators and the financial services industry at the global, European, and national levels
6. **Develop a quasi-bankruptcy procedure for banks** which instead of just applying the principle of "too big to fail" provides the intervening State with the right to replace management, to adjust claims and to protect public interest in failing financial institutions without harming the well-functioning of the bank's systems with regard to the markets. Public guarantees and subsidies to banks should be given only with the obligation to act responsible with consumers and to return the money after it is no longer necessary to keep the bank from failure.