Written evidence to the Welfare Reform and Work Bill Committee

Summary

- While the current welfare safety net is not always adequate to ensure all households can make ends meet, it is protecting a much larger number of struggling households from complete financial meltdown in the aftermath of a temporary setback.
- The Welfare Reform and Work Bill will introduce major changes to the current welfare safety net. We are concerned that some of these changes may push a significant number of already struggling households into unmanageable debt. **We urge the Government to commit to ensuring that an effective safety net against income shocks remains a key outcome of welfare reform.**
- In particular we highlight our concerns about the following proposed changes:
  - The introduction of a two child limit for the child element of Child Tax Credit (CTC) and Universal Credit (UC) and the abolition of the family element in tax credits (Clauses 11 and 12).
  - Changing the waiting period for support for mortgage interest (SMI) eligibility from 13 to 39 weeks (Clause 16)
  - Changing SMI from a benefit to an interest-bearing loan, secured against the mortgaged property. (Clauses 16- 18)

Child Tax Credit

- Nearly 3 million families are struggling to pay their bills and credit commitments[i]. Larger families are particularly vulnerable. **Removing the child and family elements of benefits and tax credits is likely to significantly increase the financial vulnerability of these households affected by the changes in future.**
- We suggest an adjustment period of up to one year from the start of a claim period where claimants would continue to receive both a child element for CTC and Universal Credit for all their children and the family element.

Support for Mortgage Interest (SMI)

- We are concerned that changing the waiting period for support for mortgage interest (SMI) eligibility from 13 to 39 weeks is forgetting the lessons learned in the previous decade, where Government sponsored research repeatedly identified the 39 week SMI wait in particular as a barrier to sustainable home ownership. **Therefore we believe that that the Welfare Reform and Work Bill should be amended to keep the SMI waiting period at 13 weeks.**
- We do not believe that the Government has made the case for the policy objective or the SMI loan proposals, at least for support for people in temporary financial difficulty. **The proposals should be amended so that SMI support would remain as a benefit, not a loan, for up to the first 12 months of a period of SMI support.**

Background on household debt

1. StepChange Debt Charity is the largest specialist provider of free, independent debt advice operating across the UK. In 2014, almost 600,000 people came to us for help with their debts.

2. Around 15 million people are financially vulnerable - falling behind on bills and using credit to meet essential costs. 2.9 million are in severe problem debt. Debt drives mental and physical health problems, splits families, causes unemployment and worsens productivity. We estimate the social costs of these problems to be £8.3 billion.

3. The causes of problem debt can be complex. But when people struggle to make ends meet or experience income shocks that they can't adjust to quickly, severe financial difficulty can follow close behind. As experts in household debt we see the links between low pay, insecure employment and problem debt every day. So we warmly welcomed the Summer Budget announcement of an enhanced National Living Wage. But without the support of effective safety nets at the point when people face income shocks this won't be enough to keep households in financial difficulties afloat.

Welfare Benefits, income shocks and debt

4. Almost two thirds of our clients cite an income shock such as redundancy, reduced hours or illness as the key factor that led to them falling into debt. Nationally, only one in three people (34%) believe they could meet the cost of essential bills if they faced a 25% drop in their income.

5. For people experiencing income shocks, welfare benefits and tax credits provide a vital safety net. Around 28% of people calling StepChange Debt Charity this year had a budget deficit, even after receiving our detailed budgeting advice. This means they could not meet ongoing essential household expenditure in their current circumstances. But without the support of benefits and tax credits this would increase hugely - 67% of our clients would have deficit budgets, including 55% of our clients in working households. This is without including the contribution of housing benefits.

6. We would emphasis that the risk of debt following an income shock is an issue for working households as well as households with no adult currently in work. Around 57% of people seeking debt advice from StepChange Debt Charity are in households where someone was in full time work, part time work or selfemployment. Over half of these said a shock to their household income was the main cause of their debt problem.

7. So while the current welfare safety net is not always adequate to ensure all households can make ends meet, it is protecting a much larger number of struggling households from complete financial meltdown in the aftermath of a temporary setback, until their circumstances improve.

The Welfare Reform and Work Bill and household debt

8. The Welfare Reform and Work Bill will introduce major changes to the current welfare safety net. StepChange Debt Charity is concerned that some of these changes may push a significant number of already struggling households into unmanageable debt. In particular we highlight our concerns about the following proposed changes:

- The introduction of a two child limit for the child element of Child Tax Credit (CTC) and Universal Credit (UC) and the abolition of the family element in tax credits (Clauses 11 and 12).
- Changing the waiting period for support for mortgage interest (SMI) eligibility from 13 to 39 weeks (Clause 16)
- Changing SMI from a benefit to an interest-bearing loan, secured against the mortgaged property. (Clauses 16- 18)

The introduction of a two child limit for the child element of Child Tax Credit and Universal Credit and the abolition of the family element in tax credits and the first child element in Universal Credit (Clauses 11 and 12)

9. We know that households with dependent children can be especially vulnerable to debt. Almost 1.4 million UK families are currently in problem debt and nearly 3 million families are struggling to pay their bills and credit commitments[ii]. Larger families are particularly vulnerable. They are already more likely to be in arrears than smaller families[iii] and in greater need of a safety net following an income shock due to higher irreducible expenditure.

10. Our experience of problem debt is that small margins make a big difference. A small budget surplus can help a household begin to recover from problem debt, with the right support and forbearance from creditors. But even a small budget deficit can leave households unable to pay for essential housing costs, or food or fuel, without resorting to credit (often high cost credit) that can quickly spiral out of control.

10. Analysis based on some of our clients (people who called us in the first half of 2015 who receive CTC) shows that the proposed reduction in the CTC safety net is likely to significantly increase the financial vulnerability of households affected by the changes in future; pushing the majority of these households into deficit budgets.

The effect of capping the child element to two children (assuming all households with more than two children are affected):

- Currently 17% of CTC recipients among our clients with three or more children show a deficit budget; placing the limit on support to two children would increase this to 90%

- 69% of our clients in receipt of CTC with deficit budgets have arrears on rent, or mortgage, or gas, or electricity or council tax compared to 49% of those with a surplus.

The effect of the family element cut (assuming applies to all CTC recipients):

- The proportion of households in receipt of CTC with deficit budgets would increase to 66%.
- Households with one child would see the biggest rise - from 24% to 72% in deficit budget – an increase of 48%.

11. So removing the child and family elements of benefits and tax credits will put significantly more families in a position where they cannot cope with an income shock. Families in that position are more likely to fall into problem debt which, contrary to the principles of the Government's approach to welfare, means families are more likely to lose work or be held back at work, and take longer to find new work.

12. Increases to the personal allowance and the National Living Wage are unlikely to provide an effective alternative safety net to help families recover from income shocks from illness or unemployment. For instance recent research from Joseph Rowntree Foundation suggests that low paid working couples will only gain if both work full time. At the time of seeking advice, only around 2% of our clients in receipt of Child Tax Credit had both parents in full time work.

13. StepChange Debt Charity supports the Government's intention to ensure that work rather than welfare benefits gives families sufficient and secure income. This is in line with our clients' aspirations. But this does not reduce the need for safety nets to help households recover from periods of temporary financial difficulties.

14. So we urge the Government to commit to ensuring that an effective safety net against income shocks remains a key outcome of welfare reform.

Mitigating the consequences of the proposed changes on the effectiveness of the Tax Credit and Universal Credit safety net

15. The Government's policy objective of these changes is 'ensuring those on benefits face the same financial choices around the number of children they can afford as those supporting themselves in work'[iv].

16. However it is clear that these proposals would also withdraw support from families who were previously supporting themselves through work until a life event reduced their income from work. The figures above demonstrate how the removal of this support increases the likelihood that working families falling on hard times will also fall into problem debt.

17. Therefore we suggest an adjustment period of up to one year from the start of a claim period where claimants would continue to receive both a child element for CTC and Universal Credit for all their children and the family element.

Changes to Support for Mortgage Interest (SMI) – Clauses 16 -18

18. SMI is a key safety net for families facing an income shock who live in mortgaged property. It provides help with specified mortgage interest payments to claimants of Income Support, Income-based JSA, Income-related ESA and Pension Credit. There are similar provisions for Universal Credit claimants - but not where the claimant or their partner has any earned income, which we believe undermines the effectiveness of this safety net.

Changing the waiting period for SMI eligibility from 13 to 39 weeks

19. The current SMI scheme includes a waiting period of 13 weeks between an individual being treated as entitled to the underlying means tested benefit and when they can start receiving support for housing costs through SMI. The Government has announced an intention to return to the 39 week waiting period in place before 2009, using a regulation making power in Clause 16(3).

20. We are concerned that this is forgetting the lessons learned in the previous decade, where Government sponsored research repeatedly highlighted gaps in the mortgage safety net, and the 39 week SMI wait in particular as a barrier to sustainable home ownership[v]. Evidence from the Joseph Rowntree Foundation suggests that 44% of SMI claimants developed arrears in the 39 week wait. After the change back to a 13 week waiting period in 2009, research for both the Department for Work and Pensions[vi], and the Department for Communities and Local Government[vii] found this had been effective in holding down arrears and possessions.

21. While we recognize that the economy is in better shape than when the waiting period was reduced, these insights remain valid both for homeowners falling into financial difficulty now and in the future.

22. We are concerned that moving the waiting period back to 39 weeks will significantly increase the number of families in danger of having their home repossessed in the event of an unexpected income shock. Based on analysis of our client base, 16% of families in severe problem debt would be driven further into arrears (and therefore face increasing danger of having their home repossessed) by changing the waiting period for SMI eligibility from 13 to 39 weeks.

23. We estimate the average mortgage interest costs potentially payable by the SMI scheme for homeowners with mortgage arrears who called StepChange Debt Charity in the first half of 2015 was £61.82 per week. This equates to around 54% of a couple's personal allowance for Jobseekers Allowance. If these homeowners had to seek support from the SMI scheme, the change from a 13 week to a 39 week waiting period (so a 26 week reduction in support) would represent a loss of £1,607 on average. This would accrue directly as mortgage arrears or possibly unsecured credit debt as financially vulnerable homeowners struggle to keep up with their mortgage.

24. However some homeowners would be likely to lose significantly more as a result of this change. 32% would face a loss in support of more than £2,000 and 14% would lose between £3,000 and £4,000. For households in need of help from the SMI scheme, this is likely to significantly increase arrears, increase the likelihood of repossession and push people further into unmanageable debt.

25. The experience of our clients leads us to believe that that the Welfare Reform and Work Bill should be amended to keep the SMI waiting period at 13 weeks.

Changing SMI from a benefit to an interest-bearing loan, secured against the mortgaged property

26. Turning SMI into a system of loans represents a significant change to the social security safety net. It moves from an insurance principle (pooling risks of life events such as unemployment or illness across society), to a credit principle where

Government loans support to people in financial difficulty. StepChange Debt Charity is concerned about this change for several reasons.

27. Credit is not a good safety net for ongoing living expenses when people are in financial difficulty. Every day we see cases where people have used credit to keep up with living expenses like housing costs, food and fuel. In contrast to sustainable, affordable credit used for smoothing larger expenses, this tends to deepen financial difficulties and make debt problems harder to deal with. It is not clear that the impact assessment has sufficiently considered the consequences of extending credit on the terms suggested to financially vulnerable households to meet their housing costs.

28. A system of quasi commercial loans will undermine the effectiveness of the mortgage safety net. These loans, charged against the property, would increase homeowners' indebtedness in an uncertain and (in the short term) open ended way at a time when homeowners will be financially very vulnerable. People who use credit as all or part of how they cope with an income shock are between 8 and 20 times more likely to fall into problem debt than people who use savings or welfare safety nets. Substituting credit for welfare in a further part of the system will lead to more problem debt.

29. Double debt jeopardy: The current limits on the SMI scheme (paid at a standard mortgage interest rate and mortgage balance capped at £200,000) mean that many borrowers will not get their full interest costs met by an SMI loan. For instance 12% of StepChange Debt Charity clients with mortgage arrears would have a shortfall in mortgage interest because of the £200,000 cap if they needed to draw on SMI support. This creates double debt jeopardy – debts will accrue through the SMI loan, while mortgage arrears continue to grow as people can't afford the rest of their monthly payments.

30. Greater risk of negative equity: Research by Oxford University has shown that negative equity is a prime driving force behind voluntary possession[viii]. Securing SMI loans against property may well create or increase negative equity.

31. Increasing recourse to high cost unsecured credit:, in the years leading up to the credit crunch debt advice providers saw many examples of homeowners with mortgage arrears or facing repossession turning to subprime lenders or quick sale and 'sale and rent back' companies for help, often suffering detriment as a result[ix].

32. Worsening the "debt barrier" to work: The additional indebtedness on those households forced to repay SMI loans may delay their recovery from financial difficulties and prolong their financial vulnerability. People in financial difficulty repeatedly tell us how worries about their debts undermine their confidence and ability to find work. Worries about the level and timing debt repayments required by creditors can also become a significant disincentive to work – 48 % of out of work people with debts told us they were worried about higher debt repayments when they got back in work.

33. The policy objectives for the SMI loan proposals state that 'Support for homeowners... when unemployed or sick is fair, but it is unfair to the taxpayer to subsidise assets for the homeowner'. [x]

34. But people will seek help from the SMI scheme to cover **temporary** periods of unemployment or illness. In these cases the SMI scheme is supporting continued occupation of a home rather than subsidising asset accumulation. It is also clear that a number of Government initiatives employ public resources to help people into homeownership. Helping homeowners retain homeownership through periods of temporary hardship seems a necessary and equally fair object of public policy.

35. Furthermore in the recent past Right to Buy borrowers were the most likely to experience arrears and payment problems, according to the Financial Services Authority, who found 41% of current RTB borrowers had a record of payment problems of some kind[xi]. An effective SMI safety can help protect the Government's investment in home ownership.

36. So for these reasons we do not believe that the Government has made the case for the policy objective or the SMI loan proposals, **at least for support for people in temporary financial difficulty**.

37. For people claiming SMI support for a prolonged period the situation may be different, as housing assets will tend to accumulate value in the long term and people will have time and more options to adjust their housing situation and deal with an outstanding mortgage. **Therefore we believe that the SMI loan proposals should be amended so that SMI support would remain as a benefit, not a loan, for up to the first 12 months of a period of SMI support.** This would ensure that the SMI scheme continues to help homeowners in temporary financial difficulty stay in their homes while avoiding the possible negative consequences described above.

38. In addition we would ask the Government to give a commitment on the following points:

- **The Government should commit that no one will lose their home as a result of an SMI loan**

- **People taking out SMI loans should not face unaffordable requests for loan repayments or court action to recover any amount outstanding**
- **The Government should not seek to make a profit out of homeowners in financial difficulty as a matter of policy.**
- **People taking out SMI loans should not face any additional interest or administrative charges in respect of these loans.**
- **The Government should clarify what support will be available where SMI loans in not suitable.**

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[i] Stepchange and The Children's Society (2014) *The Debt Trap*

[ii] Stepchange and The Children's Society (2014) *The Debt Trap*

[iii] Kempson, E. Mckay, S. and Willitts,M (2004) Characteristics of families in debt and the nature of indebtedness Department for Work and Pensions Research Report No 211 (Table 2.9).

[iv] Welfare Reform and Work Bill: Impact assessment of Tax Credits and Universal Credit, changes to Clild Element and Family Element. (2015) Department for Work and Pensions

[v] See for instance: A home of my own: The report of the Government's low cost homeownership task force (2003) and Social mobility and home ownership; New Horizons Research Programme (2007).

[vi] Ford, J., A. Wallace, M Munro, N. Sprigings and S. Smith, An Evaluation of the January 2009 and October 2010 arrangements for Support for Mortgage Interest: The role of lenders, money advice services, Jobcentre Plus and policy stakeholders DWP research report 740, 2011, summary, paragraph 6

[vii] Aron J and Muellbauer J (2010) Department for Communities and Local Government

[viii] http://www.economics.ox.ac.uk/materials/papers/4426/paper499.pdf

[ix] The Financial Services Authority investigated the Sale and Rent Back market in 2012 and found that the majority of sales were either unaffordable or unsuitable. The Quick House Sale market was the subject of a report by the Office of Fair Trading in 2013 which identified multiple business practices that may not comply with the law.

[x] Welfare Reform and Work Bill: Impact Assessment for Converting Support for Mortgage Interest (SMI) form a benefit into a loan

[xi] http://www.fca.org.uk/static/documents/consultation-papers/fsa-mmr-datapack2012.pdf

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