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Social Science in Government

Research into mortgage borrowing and claiming Support for Mortgage Interest in retirement

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Summary

Support for Mortgage Interest (SMI) is a payment that helps home owners of both working age and in retirement on qualifying benefits with interest payments on mortgages and certain loans. DWP were interested in understanding the role of SMI in mortgage decision-making and the implications for welfare provision and benefit design of the large numbers of older borrowers with mortgages stretching into retirement or approaching the end of interest-only mortgage terms without a repayment vehicle to repay capital borrowing. Research rested on a literature review, original qualitative research with low-income mortgagors and secondary analysis of both Family Resources Survey and Council of Mortgage Lenders survey data.

There was little prior awareness of SMI among SMI claimants and virtually no awareness of SMI among the wider population of low-income mortgagors. The availability of SMI had played no role in mortgage decision making.

Among low-income mortgagors, borrowing into retirement and taking on interest-only mortgages had largely been driven by affordability considerations. Most interest-only borrowers understood the interest-only concept and had repayment strategies in place, which do not differ greatly from those of interest-only mortgagors who have repaid their borrowings historically. Some elements of repayment plans may, however, no longer be realisable in a post-Mortgage Market Review world in which mortgage lending to older borrowers will be significantly constrained. A sub-set of interest-only borrowers do not understand the product concept, however, and are unaware of the risk of losing their home at the end of the mortgage term.

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List of abbreviations

AHC	After housing cost
BHC	Before housing cost
BHPS	British Household Panel Study
CML	Council of Mortgage Lenders
DWP	Department for Work and Pensions
ELSA	English Longitudinal Study of Ageing
ESA	Employment and Support Allowance
FCA	Financial Conduct Authority
FRS	Family Resources Survey
FSA	Financial Services Authority
IO	Interest-only
IS	Income Support
ISA	Individual Savings Account
JSA	Jobseeker’s Allowance
LTV	Loan to Value
MMR	Mortgage Market Review
MPPI	Mortgage Payment Protection Insurance
PC	Pension Credit
PSE	Poverty and Social Exclusion
SHE	Survey of English Housing
SPa	State Pension age
SMI	Support for Mortgage Interest
UC	Universal Credit

Glossary of terms

Capital repayment mortgage	A type of mortgage in which payments made by the borrower cover both interest and capital repayments on the sum borrowed, in differing proportions during the course of the mortgage term.
Capital sum	In this context, the sum owed to the mortgage lender and borrowed originally from the lender to purchase a property or as a further advance.
Endowment mortgage	A type of mortgage in which payments made by the borrower cover only the interest on the loan while separate payments are made to an endowment policy linked to the mortgage, and often taken out at the same time as the mortgage, which is intended to pay the capital at the end of the mortgage term.
Endowment policy	An investment policy, popularly known as an 'endowment', in which regular payments are made to a savings vehicle intended to repay capital borrowing and heavily promoted by lenders in the late eighties and early nineties as a means of not only repaying the mortgage, but building up an additional capital sum. Endowment policies have not performed in line with early projections and some borrowers face a shortfall in the value of their policy relative to the capital sum borrowed.
Endowment shortfall	The gap between the value of a maturing endowment policy (typically timed to coincide with the end of the mortgage term) and the value of the capital sum to be repaid at the end of the term.
Equity release	An arrangement whereby older borrowers can release some of their housing wealth by means of a charge on a property. The lender advances a sum to the mortgagor, on which the interest rolls up until the property is sold, when the total advance plus accumulated interest will be paid to the lender from the proceeds of the sale. There is typically a minimum age with a specified maximum loan to value ratio which varies by provider.
Home owner	Someone owning their own home, singly or jointly with someone else, and with or without a mortgage.
Housing equity	The difference between the price of the property that could be achieved with a sale and the mortgage borrowing, if any, secured on the property.

Interest-only mortgage	A type of mortgage in which payments made by the borrower cover only the interest on the capital sum borrowed and which does not repay the capital, which must be repaid at the end of the mortgage term.
Investment vehicle not linked to the mortgage	In this context, an investment vehicle set up with the intention of repaying all or part of the capital sum borrowed, but not formally linked to the mortgage.
Lifetime mortgage	An arrangement whereby a mortgage is taken out and on which no payments are made, but on which interest accumulates. Contract terms vary, but the borrower typically has the right to remain in their home until they or the last surviving spouse dies or goes into residential care. The borrower retains ownership of the property and any remaining equity and the mortgage and accumulated interest is redeemed on the death of the borrower or the last surviving spouse or at the point of entry to residential care by the surviving spouse.
Loan to value ratio	In this context, the ratio of the mortgage borrowing on a property relative to the sale price that could be achieved for the property.
Low-income	In this context, refers throughout this report to those in the lowest 50 per cent of household incomes, unless otherwise specified.
Mortgage Market Review	A review of the responsible lending practice of mortgage lenders, undertaken by the Financial Services Authority in 2010 which gave rise to new responsible lending rules for lenders which mandated various specified affordability checks based around borrowers' income and outgoings and which sought to ensure that all mortgagors would be able to repay their mortgage in full at the end of the mortgage term and that they would be in a position to service mortgage debt on a 'capital repayment' basis even if interest rates were to rise from the level current when the mortgage was taken out. The new rules have resulted in the effective disappearance of interest-only mortgages, which had been widespread prior to the Mortgage Market Review (MMR) and a significant restriction of mortgage lending to certain borrower types, including older mortgagors who have found it difficult to meet the new affordability criteria.
Mortgage term	The length of the period over which the sum borrowed is to be repaid, starting at the date of the original mortgage advance and ending with the date at which the capital must be repaid to the lender in full.

Mortgage-linked investment vehicle	An investment vehicle set up at the same time as the mortgage and linked to it and intended to repay the capital sum in full at the end of the mortgage term.
Mortgagors	A home owner who has a mortgage on their property.
Older borrowers	In this context, refers throughout this report to mortgagors over 55, unless otherwise specified.
State Pension age	The age at which individuals are entitled to claim State Pension.
The end of the mortgage term	The point at which the capital sum borrowed at the start of the mortgage contract must be repaid to the lender in full.
Working-age	The adult population below State Pension age.

Executive summary

Project background and aims

Support for Mortgage Interest (SMI) is a payment that helps home owners of both working age and in retirement on qualifying benefits with the interest payments on mortgages and certain loans. From April 2018, SMI will be treated as a state-backed loan paid direct to the mortgage lender. SMI was originally intended to provide short-term help to prevent repossession by making a contribution to mortgage interest payments while claimants took steps to move back into work. Over time, however, SMI has been paid to some recipients for extended periods and has been increasingly claimed by retired mortgagors on Pension Credit.

The Department for Work and Pensions (DWP) was interested in the implications for welfare provision and SMI of a) the large numbers of older mortgage borrowers with terms stretching into retirement and b) the position of older interest-only borrowers approaching the end of their mortgage term without a linked investment vehicle or other means to repay their capital. DWP also wanted to understand how far the availability of SMI may be influencing older borrowers' decisions on taking on interest-only borrowing and/or mortgage terms stretching into retirement.

Research methods

The research methods were:

- a literature review;
- qualitative research with those approaching and in retirement and SMI claimants of both working age and in retirement; and
- secondary analysis of the Family Resources Survey (FRS) and Council of Mortgage Lenders (CML) survey data.

Key findings

- Around half of those with a mortgage aged 50–64 are scheduled to repay their mortgage after the age of 65. One in five households over 60 who have a mortgage have an interest-only mortgage with no linked investment vehicle, this being much more common among those on the lowest incomes.
- For those on low incomes, the decision to take on interest-only borrowing and to extend mortgage terms into retirement has been driven by affordability considerations and a trade-off between housing need and available resource. A desire for flexibility on the timing of repayment of capital and to maximise long-run house price inflation are also factors.

- Most interest-only borrowers understand the nature of the product and the need to repay capital at the end of the term and have a strategy in place, albeit that this may not be sufficient or certain (as in the case of inheritance) to repay capital. Just three in ten plan to repay with an investment vehicle. There is however a sub-set of low-income interest-only borrowers, around one in five, who do not understand the need to repay capital or appreciate the risk that they may lose their home.
- Strategies for repayment for the current generation of interest-only borrowers are not very different from those used by historic interest-only borrowers who have repaid their mortgage successfully.
- For many low-income mortgagors, plans which rest on extending mortgage terms, remortgaging or downsizing and taking on new borrowing at a reduced level, may no longer be viable in the light of new responsible lending criteria which have followed from the Mortgage Market Review (MMR), which have made it more difficult for older borrowers to gain access to mortgage lending.
- There is very little awareness of SMI among mortgage borrowers or among SMI claimants prior to a claim. The availability of SMI appears to have played no role in mortgage decision making.
- SMI claimants tend to be more disadvantaged than other mortgagors or those on qualifying benefits, having experienced an adverse life event and income shock, triggering an SMI claim. The profile of current SMI claimants suggests that they will increasingly be dependent on SMI for the long-term.
- The qualitative research suggests that for all the recipients of SMI interviewed, SMI had enabled them to maintain housing stability when they would otherwise have been unable to cover their mortgage payments and thus could have faced losing their home, which could have exacerbated already stressful personal circumstances. Those interest-only mortgagors most likely to claim SMI appear also to be those least able to repay capital or understand the risks they face. There is a risk of both these borrowers and those no longer able to borrow under new lending criteria being diverted to the rental sector, creating significant hardship and increased housing costs for the welfare system.

Conclusions

The incidence of claiming SMI is not readily amenable to policy intervention or behaviour change of communications initiatives. SMI appears to be delivering real benefits to claimants following a downturn in personal circumstances and associated income shock.

Borrowing into retirement does not of itself appear to be a major issue for most older mortgage borrowers. These borrowers would seem likely to extend their working lives past retirement age to support additional years of servicing mortgage repayments. Mortgage balances are in most cases low and mortgage payments are considerably cheaper than rents for this age group.

The larger issue is the need for capital repayment at the end of the mortgage term for that minority of interest-only borrowers who either do not understand the risk they face, are unable to repay their capital in part or in full or who will now be unable to find a market-based solution for their need to extend the mortgage term, or take on new borrowing.

1 Policy background, research aims and methods

This chapter covers the policy context in which the research was commissioned by the Department for Work and Pensions (DWP), the broad aims of the research and key research questions, and a brief description of the research methods.

1.1 The policy context and research background

DWP was interested in the potentially large numbers of older mortgage borrowers with terms apparently stretching into retirement[1]. The Department was also interested in understanding more about the proportion of older borrowers with interest-only mortgages, and, within this, the numbers of individuals with interest-only mortgages and no linked investment vehicle, a phenomenon concentrated among the low-income households most likely to rely on welfare in retirement.

Little is known about the thinking of home owners on how they will service their mortgage in retirement or about how the relatively large numbers of older low-income home owners with an interest-only mortgage and no formal repayment vehicle plan to deal with the requirement to repay their capital at the end of their mortgage term.

Moreover in many cases the mortgage choices of older borrowers were made prior to the financial crisis. The large numbers of borrowers taking on mortgages into retirement and interest-only mortgages arose in the era of relatively easy access to credit which preceded the financial crisis. Since that time the Financial Services Authority’s 2010 Mortgage Market Review (MMR) has changed the landscape for mortgage borrowing, and particularly for older borrowers. The MMR focused on the ‘responsible lending’ practice of mortgage lenders with a view to ensuring that in future borrowers were able to repay mortgage borrowing and service their mortgage debt without undue financial strain. The new responsible lending regulation required lenders to impose much stricter mortgage borrowing criteria than historically and led to the withdrawal of certain mortgage types, for example higher-interest mortgages based on ‘self-certified’ income and many interest-only products. Lending to some consumer types, including older borrowers, has been significantly constrained, albeit that there has been some recent effort by some large lenders to extend the age at which mortgages must be repaid in full. Nonetheless older borrowers are now significantly less likely to be able to meet the new affordability criteria, and, in particular, the requirement to demonstrate the ability to repay their mortgage on a repayment basis and at a higher interest rate than is applicable currently. For interest-only borrowers this will be a significantly greater outlay than their current payments and will be particularly challenging for low-income older borrowers. Little is known, however, about whether these developments will have influenced or changed the thinking and planning of older mortgage borrowers around either servicing mortgage debt in retirement or paying off the capital on interest-only mortgages.

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[1] For the purposes of this report, and in the secondary analysis of the quantitative data which contained age breaks below and after 65, we have treated age 65 as being a proxy for retirement age.

DWP also wanted to understand the implications of these phenomena for welfare support for mortgage borrowing into retirement and, in particular, how the availability of Support for Mortgage Interest (SMI) payments might be influencing potential claimants' decisions or thinking around borrowing into retirement or taking on interest-only mortgages.

SMI is a payment that helps home owners on specific qualifying, income-related benefits (including Income Support (IS), income-based Jobseeker's Allowance (JSA), income-related Employment and Support Allowance (ESA), Pension Credit (PC) and Universal Credit) with interest payments on mortgages or certain loans that have been taken out for repairs and improvements. SMI covers only the interest element of the mortgage (up to a maximum of £200,000 for those of working age and £100,000 for PC claimants) and not repayment of capital. It is paid direct to mortgage providers in the vast majority of cases and is calculated by applying a standard interest rate. It can be claimed 39 weeks after first claiming a qualifying benefit for working-age claimants. There is no waiting period for PC claimants, who can receive SMI from the start of a claim. Those claiming JSA can only receive SMI for a maximum of two years, while those claiming ESA, IS, or PC can claim indefinitely while their mortgage is outstanding.

SMI is currently in the process of being reformed, as part of the wider Government Welfare Reform agenda. From April 2018, payments to lenders will now be treated as a state-backed loan to the mortgagor rather than a paid benefit. The loan will ultimately be repayable to DWP by the mortgagor, either voluntarily on return to work or when the property is sold. The Department will take a charge over the property to protect their interest.

SMI was introduced in 1948 as a working-age benefit intended to provide short-term assistance, for those experiencing disruption to their employment, to prevent claimants losing their home while they took steps to move back into work. Over time, however, SMI has been paid to some recipients for extended periods, including to long-term benefit claimants on ESA and disability-related benefits and pensioners as well as those moving in and out of work.

Against this background, and that of a relatively large cohort of mortgagors approaching retirement age, the Department has been keen to understand the implications of these trends for future provision of, and demand for, SMI.

The research was commissioned to address these evidence gaps and to understand how these trends and developments, particularly as they apply to low-income mortgagors, will influence propensity to need and claim SMI in the future.

1.2 The research aims

The Department wished to understand why people are taking mortgages into retirement and when they rely on SMI, why they do so. The intention was that the research would inform DWP's thinking about appropriate policy responses to the phenomenon of mortgage borrowing into retirement, and inform the future development of SMI.

The key research questions were as follows:

- Why do people take their mortgages into retirement? What circumstances have led to this?
- What are people's expectations (if any) around SMI and mortgage payments as they approach retirement?

- Do people with interest-only mortgages plan to pay off the outstanding capital sum at the end of the term? If so, how?
- Why do people in retirement claim SMI?
- What factors, including beliefs and attitudes lead to people's decisions to take their mortgage into retirement and claim SMI?
- If SMI were not available through PC, what would claimants do instead of claiming SMI?

Additionally, the secondary analysis aimed to provide:

- A statistical profile of PC claimants in receipt of SMI.
- Some quantification of the issues arising from the qualitative work.

1.3 Research methods

The research methods rested on:

- A literature review.
- Qualitative research with those approaching and in retirement and SMI claimants of both working age and in retirement.
- Secondary analysis of Family Resources Survey (FRS) and Council of Mortgage Lenders (CML) survey data.

1.3.1 The literature review

The literature review process commenced with a search for potentially relevant material, using resources such as the Repec, JSTOR databases and SSRN, Google Scholar and the publication lists of various research institutions and centres (e.g. the Centre for Housing Policy at the University of York, the Institute for Fiscal Studies, etc.). However, it quickly became apparent that the literature around mortgages into retirement is mainly focused on topics such as why homeowners do not draw down more of their housing equity in retirement and has little to say on why people take mortgages into retirement, with the exception of a 2010 Policis report for the CML. Similarly, the question of why people claim SMI while taking mortgages into retirement has not been addressed in the literature. For this reason, the literature review itself focused on providing an overview of SMI take up and use, a profile of mortgage borrowing into retirement, an overview of poverty risk and home ownership and of the home ownership risks and the risks of mortgage arrears as these apply to those on low incomes. This report draws selectively on key points from it.

Given the weakness of the literature in addressing the key research questions, the project was extended to include secondary analysis of FRS data to provide a detailed profile of SMI claimants and mortgage borrowing trends and of CML data around the motivations for borrowing into retirement and intentions on repayment of interest-only mortgages.

The literature review was provided to DWP at an early stage of the report as an input into the framing of the qualitative research and secondary analysis. The major part of the literature review is included as Appendix A.

1.3.2 Qualitative research with SMI claimants and low-income home owners approaching and in retirement

The qualitative research was designed to uncover the dynamics of decision making and choices around borrowing into retirement, thinking on repayment of interest-only mortgages and on claiming SMI. The qualitative research aimed to cover home owners on low incomes in a variety of circumstances who were either existing SMI claimants, both of working age and in retirement, or potential SMI claimants for the future in that individuals were likely to be dependent on State Pensions and had mortgage terms stretching into retirement. The sample was structured to include both those who had chosen to borrow into retirement, but with repayment or endowment mortgages and those borrowing into retirement with interest-only mortgages. On the basis of the secondary analysis of the CML and FRS data, there was also emphasis within the sample on those who had taken on interest-only mortgages on affordability grounds and those borrowers who were formerly social housing tenants who had purchased their property under 'Right to Buy' legislation. All borrowers fell within the lowest 50 per cent of gross pre-tax household incomes and are henceforth described in this report as 'low-income'.[2]

The qualitative research rested on 51 depth interviews with:

- Current PC claimants claiming SMI (ten).
- Current SMI claimants approaching retirement age (eight).
- Low-income right to buy borrowers with terms stretching into retirement [non-SMI claimants] (eight).
- Low-income borrowers with repayment/endowment mortgages with terms stretching into retirement [non-SMI claimants] (ten).
- Interest-only borrowers with mortgage terms stretching into retirement and with stretched affordability [non-SMI claimants] (15).

Fieldwork was undertaken in March 2016 and was based on a mix of telephone and face-to-face interviews, according to interviewee preference. Interviews were approximately forty-five minutes in length. Respondents were recruited from areas with a mix of housing experience, including in areas where property prices had appreciated significantly, those where property prices had remained broadly stable and those where property prices had fallen. A full list of areas in which the research took place and a detailed profile of respondents are included in the technical appendix. SMI claimants were recruited from a sample provided by DWP while the other respondents were 'free-found'.[3]

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2 The definition of 'low-income' as falling into the lowest 50 of household incomes was used in this report because the CML data-set used for the secondary analysis contained only income breaks by income deciles. In the report we have based analysis of low-income households primarily on mortgagors in the lower 50 per cent of household incomes, there being relatively few individuals having mortgages and in the lowest 30 per cent and 20 per cent of household incomes.

3 Respondents were recruited by means of a personal approach to potential respondents by professional recruiters with potential research participants then taken through a screening process to ensure that they met the interview criteria as laid out in the fieldwork specification.

All the interviews were digitally recorded and fully transcribed and the resulting qualitative material was analysed using a thematic grid designed to enable systematic, structured and balanced analysis of large quantities of qualitative material.

1.3.3 Secondary analysis of FRS and CML data

FRS data

The secondary analysis of FRS data was intended to supplement the literature review and the secondary analysis of CML data by providing contextual trend data on mortgage borrowing into retirement, interest-only mortgage borrowing and trends in SMI claims.

The FRS is a large-scale continuous survey of the population which collects detailed information on income and receipt of benefits. The FRS also contains information on mortgages taken out by respondents to purchase their accommodation. The FRS sample size is currently in the region of 20,000 annually, including around 6,000 households owning with a mortgage.

The specific aims of the FRS secondary analysis were as follows:

- To compile a statistical profile of claimants in receipt of SMI, focusing primarily on those aged 50–59 and 60 plus.
- To identify trends in the propensity for households to take mortgage into retirement, including the take up of interest-only mortgages.
- To provide a statistical context for the presentation and interpretation of the qualitative research findings.

The FRS survey data sets for each year from 2002/03 to 2013/14 (the latest available at the time of the research) were downloaded from the UK Data Archive. The datasets were processed to compile a range of indicators for profiling the following main population groups:

- SMI recipients.
- In receipt of a qualifying benefit and with a mortgage but not receiving SMI.
- All other households owning with a mortgage.

The main topics included in the profile dataset were: demographics; economic status; income, savings and pension provision; receipt of benefit; and, problems paying household bills. Information was also compiled on the mortgages held by survey respondents, including: type; term; years left; and, loan values.

There is in any case a low incidence of SMI recipients within the general population. To compensate for underreporting within the FRS of PC receipt, the qualifying benefit for SMI for people of pension age (and the consequent underreporting of SMI receipt in the population), it was necessary to pool FRS data for the five years 2009/10 to 2013/14 to ensure adequate sample sizes for the effective profiling of SMI recipients.

CML data

The secondary analysis of the CML data was intended to help the Department understand:

- The factors that have led older borrowers to take on mortgages stretching into retirement.
- How older borrowers think about mortgage borrowing in retirement and how they plan to service mortgage debt.
- How interest-only borrowers, and older interest-only borrowers in particular, think about repaying their capital at the end of the mortgage term and how they plan to do so.
- The potential risks and challenges that may arise for the older mortgage borrowers on low incomes most likely to become SMI claimants.

Analysis drew on quantitative research data from a survey undertaken with a nationally representative sample of 3,000 aspiring home owners, mortgagors and home owners who had repaid their mortgage, undertaken by Policis for the CML in 2010. The mortgage market has changed considerably since this time, reflecting both the impact of the MMR and wider developments in the housing market.

The greatest change has been a sharp decline in the proportion of young people owning their homes[4]. This has arisen as a consequence of a combination of a number of factors. Following the implementation of the MMR, some first-time buyers have found the significantly more challenging affordability criteria difficult to meet and younger first time buyers have also struggled with lenders' requirements for relatively large deposits. Additionally rapid house price inflation, especially in London and the South East has put home ownership out of reach for some younger would-be buyers. The effective disappearance of residential interest-only mortgages has also played a role. Prior to the MMR, interest-only borrowing had become an important route into home ownership for those buyers unable to afford or unwilling to take on capital repayment mortgages.[5]

4 Home ownership among younger age groups is now at its lowest level for 30 years. There are fewer first-time buyers compared to historically and first-time buyers enter home ownership later, typically in their late 20s compared to early 20s as historically. Between 1993 and 2003, first-time buyers' numbers over the period were close to 500,000 each year, but by 2014, first-time buyer numbers had fallen to 311,500. In 1993, 32 per cent of under 25s, 63 per cent of 25–34-year-olds and 72 per cent of 35–44-year-olds were home owners. By 2013/14, less than ten per cent of under 25s, 35 per cent of 25–34-year-olds and 58 per cent of 35–44-year-olds were home owners. (Source CML calculations based on English Housing Survey data).

5 In the period immediately prior to the financial crisis, almost a third (32 per cent) of all mortgages in 2007 were sold on an interest-only basis. By 2010 at the point of the MMR interest-only mortgages represent circa 32 per cent of value of all outstanding mortgages. Source: CML.

Lending to older borrowers has also been falling (with the exception of equity release products) and borrowing options for older mortgagors which might have been possible prior to 2010 may now not be available, particularly for older borrowers on low incomes or interest-only mortgages who may struggle to meet stricter affordability criteria. The 2010 data is valuable therefore, because it reflects the plans and thinking of older mortgagors in relation to borrowing into retirement and management of the end of the mortgage term, prior to the regulatory intervention. The qualitative research undertaken for this project suggests that older low-income borrowers may not be aware that the mortgage landscape in which they made their plans has changed significantly in the intervening years. Detailed analysis of the changes in mortgage lending is provided in Chapter 2.

Survey questions covered the detail of mortgage borrowing and borrowers' finances but also their thinking in mortgage decision making and product choices. It also covered their plans and aspirations for the future, their intentions on future mortgage borrowing and their plans and resources for servicing mortgage debt and, ultimately, repaying capital at the end of the mortgage term.

Secondary analysis focused primarily on low-income mortgage borrowers (in the lowest 50 per cent of gross pre-tax household incomes) and those over 55 and either in or approaching retirement.

In some cases bases are relatively small. In these cases data should therefore be regarded as indicative. Differences reported are statistically significant at 95 per cent confidence unless otherwise stated. Small sample sizes are indicated by being contained in square brackets.

2 Mortgage borrowing into retirement and trends in interest-only mortgages among older borrowers

This chapter seeks to provide some sense of scale for the potential implications of borrowing into retirement for welfare provision and draws on secondary analysis of the Family Resources Survey (FRS) data. It describes the trends in borrowing into retirement and in taking on interest-only mortgages and provides indicative estimates of the likely scale of future demand for Support for Mortgage Interest (SMI) and of the numbers of potential future SMI claimants who may be approaching the end of an interest-only mortgage term with no linked investment vehicle in place to repay the capital.

Key messages

- Home ownership supported by mortgage borrowing has been in decline in recent years, which is attributable to a rise in the age of mortgage taking. The proportion of households owning their home with a mortgage has stayed stable among those over 50.
- Around half of those with a mortgage now aged 50–64 are scheduled to repay their mortgage after the age of 65, some 1.2 million households.
- One in five households aged over 60 who have a mortgage have an interest-only mortgage with no associated investment vehicle. Across all ages, this is much more common among home owners in the lowest income quintile (16 per cent versus 9 per cent overall).
- There are clear cohort effects visible in the data which suggests that as the generation now in their 50s grows older, this will increase the stock of older mortgagors borrowing into retirement and with interest-only products.

2.1 Mortgage borrowing by age and type of mortgage

The proportion of households owning with a mortgage has been in decline since 2008, due to a significant fall in home ownership among the young. Over the last decade the proportion of households owned with a mortgage has stayed relatively stable among those where the head of the household is aged 50 plus. Among those now aged 50–64, and based on their mortgage terms as reported in the FRS, a little more than one in two (51 per cent), equating to almost 1.2 million households, are scheduled to repay their mortgage sometime after turning 65. One in five households (20 per cent) aged 60 plus who have a mortgage have an interest-only mortgage with no linked investment vehicle. Interest-only mortgages with no linked investment vehicles are, moreover, much more common among those mortgagors in the bottom 20 per cent of income distribution, being almost twice the level among the population of interest-only mortgage borrowers overall.

Table 2.1 Mortgage type by age of household head, 2013/14 for under 50s, 50–59 and 60 plus (per cent of all owner-occupied with a mortgage)

	Repayment	Repayment and interest-only	Endowment	Interest-only, linked investment(s)	Interest-only, no linked investment	Grossed-up base (millions)
	%	%	%	%	%	
Aged under 50	85	2	2	3	7	5.541
Aged 50-59	74	6	6	4	10	2.001
All aged 60+	58	5	7	10	20	0.682
Of which:						
• Aged 60-69	61	6	8	8	16	0.557
• Aged 70+	44	1	4	17	34	0.124
All	80	3	4	4	9	8.223

Source: FRS 2013/14.

For the population as a whole the proportion of households with interest-only mortgages and no linked investment vehicle has been falling, since the requirements of the Mortgage Market Review (MMR) were introduced in 2010. However, the decline has been primarily in mortgagors under 50, most likely to be taking on new mortgages, among whom the incidence of such mortgages has fallen by 39 per cent since 2008/09. By contrast, among mortgagors aged 50–59, there has been an increase of 22 per cent in the years between 2008/09 and 2013/14 while the stock of mortgagors among those aged 60 plus with such mortgages has remained close to the 2009/10 level. The incidence of maturing interest-only mortgages is expected to peak in 2032.[6]

Table 2.2 Trends in interest-only mortgages 2005–2014 under 50s, 50–59 and 60 plus

Households with interest-only, no linked investment mortgages, 2005-2014				
	Under 50	50-59	60+	All
	No.	No.	No.	No.
2005/06	354,000	109,000	110,000	573,000
2006/07	432,000	112,000	117,000	661,000
2007/08	537,000	126,000	81,000	744,000
2008/09	622,000	158,000	142,000	921,000
2009/10	598,000	134,000	149,000	882,000
2010/11	544,000	157,000	140,000	841,000
2011/12	568,000	144,000	148,000	861,000
2012/13	485,000	175,000	157,000	816,000
2013/14	379,000	192,000	134,000	705,000

Source: FRS 2005/06 to 2013/14.

6 Source: Council of Mortgage Lenders, 2014.

Table 2.3 Households with interest-only, no linked investment mortgages 2005–2014 as per cent of all mortgages

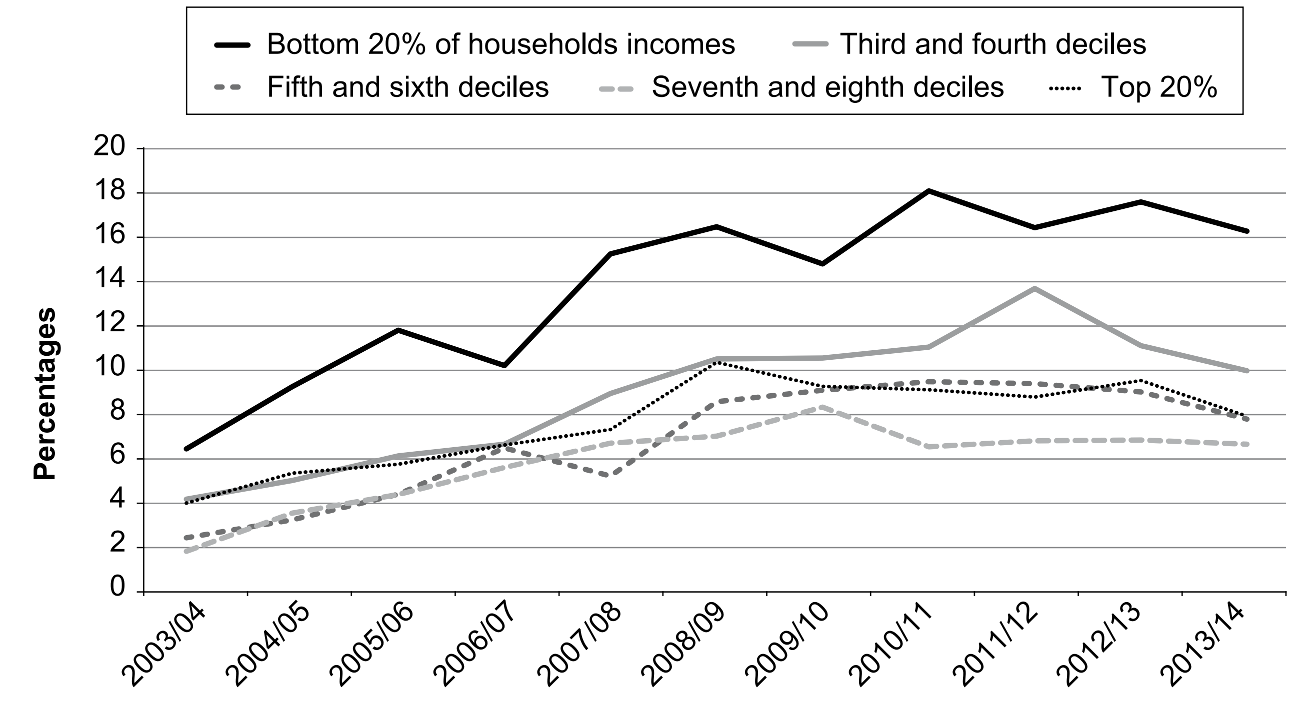
Households with interest-only, no linked investment mortgages, 2005-2014	Under 50	50-59	60+	All
	%	%	%	%
2005/06	5	5	16	6
2006/07	6	6	17	7
2007/08	8	7	12	8
2008/09	9	9	21	10
2009/10	9	7	21	10
2010/11	9	8	22	10
2011/12	9	7	21	10
2012/13	9	9	22	10
2013/14	7	10	20	9

Source: FRS 2005/06 to 2013/14.

2.2 Low-income households and interest-only borrowing

As can be seen in Figure 2.1 the increasing trend until 2008/09 in take-up of interest-only, no linked investment vehicle mortgages has been most pronounced among the lowest income households.

Figure 2.1 Trends in interest-only mortgages 2005–2014 by income quintile: Per cent of all households owning with mortgage



Source: FRS 2003/04 to 2013/14.

3 The dynamic of mortgage choices among older low-income borrowers

This chapter draws on both the qualitative research undertaken to inform this project and secondary analysis of the Council of Mortgage Lenders (CML) data. It examines broad attitudes to home ownership and the perceived role of home ownership and property wealth in financial security and planning for retirement. It also discusses the dynamic underpinning mortgage decision making and the choice of both different mortgage types and the drivers of mortgage borrowing into retirement. It also describes views on how property wealth and mortgage borrowing sits within planning for later life.

Key messages

- Older mortgage borrowers' decisions on home ownership and mortgages has been fundamentally rooted in the conviction that home ownership is always a superior choice, no matter what the accommodations and compromises (such as interest-only borrowing or extended mortgage terms) that may have to be made to achieve it. Home ownership is seen as a central plank of financial planning and security, driven by expectations that price inflation will create wealth and thus self-determination and choice.
- Against this background, mortgage product choices for those on low incomes have been driven by pragmatic considerations of a trade-off between affordability and housing need. The choice of interest-only mortgages (and indeed extended mortgage terms) can be seen as, for most, an informed and pragmatic decision which represents the perceived optimal solution, given constrained options and limited resource to service mortgage debt and get onto 'the property ladder'.
- There is a sub-set of unsophisticated and low-income interest-only borrowers, often those on the very lowest incomes, who do not understand the product choices that they have made (or which have been effectively made for them) and who do not understand that at the end of their mortgage term they will still owe the capital borrowed and thus be at risk of losing their home.
- There is a sub-set of borrowers with endowment mortgages with lapsed investment vehicles who did not understand that they were now effectively paying an interest-only mortgage.
- Older borrowers have made their plans and mortgage choices in a very different mortgage environment, where borrowing into retirement was normalised, and funding was accessible, with many taking the view that borrowing into retirement was a better use of funds than repayment of capital. Against the current background of the Mortgage Market Review (MMR), however, many would-be older borrowers, especially those on low incomes, will no longer meet responsible lending criteria. Few low-income mortgagors in their 50s and 60s appear aware that borrowing conditions have now changed for older borrowers.

- For the better off, extending mortgage terms into retirement is driven by a desire to support enhanced lifestyles mid and later life. For those on low incomes, and especially those with interest-only mortgages, mortgage terms stretching into retirement are driven by affordability considerations and the desire to minimise outlay. Expectations of extended working life are also a factor.
- Where older borrowers have planned to move or downsize in later life, this has been done with a view to primarily release funds for use in later life, rather than for repaying the mortgage in full. These plans have, however, been predicated on having access to further mortgage borrowing in retirement to support purchase of a smaller property. The market has yet to generate attractive and good value solutions to what may become a pressing problem for older low-income borrowers, and by extension, for welfare provision. Many older mortgagors were interested in equity release or lifetime mortgages in principle, but saw existing products as poor value and providers as exploitative.

3.1 Attitudes to home ownership

It was clear from both the qualitative and quantitative research that home owners of this generation (i.e. those now in their 50s and older) have very much taken for granted that home ownership is a ‘norm’ and the foundation-stone of personal financial security. ‘The property ladder’ was seen as the route to asset and wealth accumulation. For many low-income home owners, buying their home was essentially the sum of their financial planning.

> *‘It was the thing, you know it was basically instilled into us, really it was your future, not just for you but for your children and you just did it … Because, you know, any equity we have in this is basically all we’ve got.’*

Home ownership was seen also, on the one hand, as insurance against misfortune, and, on the other as providing personal choice, financial and otherwise. Housing wealth was seen as the ultimate back-stop in crisis or a downturn in circumstances.

> *‘Well, I’ve been brought up never to rent, always buy. Because there’s always equity in your home, there’s money in bricks and mortar … if anything was to happen, like health-wise or anything like that, I can always downsize. And I’ve got the capital left I can use for an early retirement.’*

In the CML data some 65 per cent of mortgagors over 55 in the lowest 50 per cent of household income agreed that ‘Buying your own home is the best way to invest in your future financial security’ and 55 per cent agreed that ‘in the future people are going to have to rely on property wealth to provide for their retirement and take care of themselves when they are old’.

Renting, by contrast was seen as both ‘dead money’ and to represent a lack of self-determination. Two-thirds (66 per cent) of low-income older mortgagors agreed with a statement that they would prefer home ownership to renting even if renting was significantly cheaper.

> *‘I’m a fiercely independent person. And as far as property goes I don’t like the idea of paying hundreds and hundreds of pounds to someone and not really enhancing my situation at all … to me, it gives me long-term independence.’*

More than all of this, home ownership was seen as an important component of sense of self and perceived as a central life-achievement. For the various ex-social tenants who had acquired their former rental property as a result of the ‘Right to Buy’ legislation, the move into home ownership was experienced also as progression and upward social mobility, in addition to conferring a new degree of financial security.

3.2 The profile and motivations of interest-only borrowers

There is not an absolutely clear divide between interest-only and capital repayment borrowers in that by 2010 immediately prior to the MMR some 15 per cent of mortgage borrowers had some part of their borrowing on both interest-only and capital repayment basis. Some borrowers also switch between interest-only and capital repayment borrowing at different stages of the life-cycle or during periods when expenditure is high or, conversely, when earnings are low or during periods of hardship.

That said, the CML data nonetheless shows clear differences in the profile of capital repayment and interest-only borrowers. Capital repayment borrowers are generally younger and are more likely to be family households. Interest-only borrowers are generally older (over half of interest-only borrowers are older than 50 with almost a quarter in their 60s) and are more likely to be affluent.

However, interest-only borrowers are much less homogenous than capital repayment or endowment mortgage holders. They include both affluent groups seeking maximum leverage of their income to build assets and property wealth.[7] They also include low-income mortgagors with stretched affordability for whom interest-only represents a means of minimising outgoings and attaining home ownership, which might otherwise be difficult or impossible to achieve.

3.3 Mortgage decision making and product choices

3.3.1 The drivers of mortgage choices

The qualitative research suggested that mortgage decisions appear to be largely driven by some combination of the income available for debt service, housing need and the relative sophistication of the individual concerned and the extent to which they depend on a broker or provider for direction.

7 The CML 2010 survey data indicates that for the more affluent this has been a successful strategy, with interest-only borrowers both living in higher value properties and having greater housing wealth than their capital repayment counterparts, at all stages of the mortgage cycle.

In the case of many of the older low-income mortgage borrowers, their principal mortgage decisions and their choice of mortgage vehicle – repayment, endowment or interest-only, with or without a linked repayment vehicle – often lay many years, even decades in the past. That said, many had revisited their mortgage decision at various times, either remortgaging to gain a better rate or to release funds or taking on further advances on their existing mortgage. These funds had primarily been used to support home improvement, but had also been used for repayment of debt. Where mortgage decisions were more recent, this was often driven by a, usually adverse, change of circumstances, typically divorce, bereavement or the onset of illness or disability.

It would appear that among these low-income mortgage borrowers, the choice of mortgage was determined by what they could accommodate in the way of debt service and the need to optimise their housing position at the time the mortgage was taken out.

Repayment mortgages

Both the qualitative research and the CML data suggested that those choosing and maintaining repayment and endowment mortgages were the better off among those on low incomes. These borrowers were more likely to have assets and savings, even if modest, and were more likely to be in secure work and to be two-income households. Attitudinally, these borrowers were more closely focused on the security offered by capital repayment.

> *'Because the other ones, you've got the interest-only, but I wanted a repayment. From looking at my statement, it pays the interest and the balance of the mortgage as well … otherwise it's like you're renting.'*

Generally, repayment and endowment mortgagors were more likely than interest-only borrowers to be financial planners in the widest sense. These borrowers were also more financially secure in that they were more likely to have some form of pension provision other than the state pension. As a consequence they were less likely to be eligible for or need support for paying their mortgage in retirement.

The Support for Mortgage Interest (SMI) claimants who had repayment mortgages had typically experienced a major adverse life event which had derailed their financial planning. Some had switched to interest-only prior to claiming SMI. Others had depleted savings, where these were available, to prioritise mortgage payments. Maintaining mortgage payments had typically been put before other expenditure, with some individuals suggesting that they prioritised paying the mortgage over spending on other things. Some had come close to losing their home prior to claiming SMI.

> *'The thing is that way, at the end of the day, you have still got the house, and it's yours whatever it's worth so we really, really prioritise the mortgage even though we really struggle with it … we go without and put the mortgage first.'*

Endowment mortgages and linked investment vehicles

The older borrowers with endowment mortgages often had very long-standing contracts on mortgage borrowing. These borrowers had often relied heavily on advice and direction from brokers and providers in their choice of product. Respondents reported that the initial proposition they had been sold was that endowment mortgages would not only repay their mortgage but also deliver a lump sum to cushion later life. For some, this had constituted their major savings vehicle and the realisation that they were unlikely to realise a significant capital sum at the end of the term had come as something of a disappointment.

> *'It was the thing, wasn't it, at one time. We was all going to do well out of them and your mortgage would be paid off and you would be laughing … but it didn't turn out that way … I think I am going to be 25 grand short which I am gutted about obviously.'*

Interest-only mortgages

The qualitative research with the older borrowers on low incomes suggested that choice of interest-only mortgages by those on low incomes had overwhelmingly been driven by affordability considerations and how best to make use of limited resource to meet housing need. Essentially interest-only borrowing was taken on in an effort to reduce mortgage borrowing to the lowest possible outlay. In the CML data, the three most commonly cited reasons for older borrowers to have chosen interest-only mortgages were all affordability related; the interest rate at the start of the mortgage (37 per cent), keeping the amount to be paid each month as low as possible (47 per cent) and 'affordable payments that I can be sure I can manage' (39 per cent).

> *'The whole point of taking interest-only was to keep the cost down … and I worked out the cost of some kind of insurance or endowment or whatever and it wasn't possible to pay it.'*

In some cases, individuals had been sold interest-only products as the only way that they could afford to get onto (or back onto) the 'property ladder'.

> *'Just to get on the ladder really. It was the only way I could do it at the time … I did hope, later on, I could change it. But it's not panned out that way.'*

Others had also taken on interest-only products in an effort to achieve more space or live in a better area than the household would otherwise have been able to afford. In some cases, meeting their immediate housing need had been more important than the long-term risks and implications of taking on an interest-only mortgage.

> *'We needed to get into a better area for the kids and we couldn't afford the big, big mortgage* [repayment] *so we went for the smaller one* [interest-only]*.'*

3.4 Understanding of interest-only and endowment mortgage concepts

The CML data suggests that the majority of interest-only borrowers accept and understand the risk of interest-only mortgages and the potential to lose the property at the end of the term but still think the concept worthwhile. Some 82 per cent of all those with an interest-only mortgage in the lowest 50 per cent of household income and 84 per cent of the over 55s within this group agree that '*if you have an interest-only mortgage, at the end of the mortgage term, you will still owe the whole of the sum borrowed initially*'. However, ten per cent do not know and a further eight per cent disagree (the proportions for those who are over 55 are ten per cent and six per cent respectively).

In the qualitative research, the majority of the mortgagors who had been engaged in the decision to take on an interest-only mortgage understood the nature of the trade-off that they had made and recognised the risk that they would be unable to repay the capital at the end of the term and risked losing their home. For these borrowers, the choice was seen as better than the alternative of renting.

> *'It was a no-brainer, right? No-one wants to rent if they don't have to. And you're never going to lose money on a house, are you, not in the long-term anyways.'*

The qualitative work also suggests that decisions to take on an interest-only mortgage had also been underpinned by a deep-seated expectation of house price inflation. Interest-only mortgages had been taken on with acceptance that there may well be a need to sell at the end of the term, but in the conviction that even were this to be the case, the borrower could still expect a significant capital gain.

> *'I just thought I'll take the cheapest option and then, worst case scenario, at the end of the ten years, I would possibly have to sell the property to pay off the mortgage … but the property has gone up.'*

In some cases, however, where individuals' decisions had been heavily broker or provider-driven or where decisions had been made by one partner with little or no involvement of the other, individuals could have little or no understanding of the interest-only concept or its implications.

> *'It was only after he had died that I found out that the mortgage was interest-only. I had had no idea. I thought it was just a normal mortgage. So that was a bit of a shock.'*

It was clear, however, that some unsophisticated borrowers, often ex-social housing renters, had taken on interest-only mortgages and simply did not understand the concept. In some cases, individuals believed that an interest-only product was an interest-free product.

> *'I was very lucky. I'd been renting in this house since the children were little and I was lucky enough to get the chance to buy my council house at a very good price and I was lucky also because I got an interest-free mortgage so it's all worked out rather well* [no appreciation that capital still owing at end of term].*'*

In others, individuals understood that the capital would never be repaid by making their interest-only payments but did not appreciate that the mortgage agreement was for a finite term. These individuals tended to think in terms of the loan being a permanent arrangement.

> *'I know we owe £35,000 and it* [mortgage] *won't ever be paid because, as I said, it's interest-only. So even if one of us dies, the other's still got to carry on until they die but then, when the children sell the house they've still got to pay it back.'*

Most borrowers with an endowment mortgage understood the concept, albeit that not all understood the potential for their endowment to fall short of the capital required to repay their borrowing. There were, however, similar misconceptions among some of those who had endowment products. Among those who had continued to pay into their endowment vehicle there was a mixed awareness of the value of their endowment and a similarly mixed understanding of the issues around any potential shortfall. Some mortgagors were broadly aware of their endowment value and, where necessary, had taken steps to make good any shortfall. Others were unaware of the value of their endowment but remained confident it would be sufficient to repay their mortgage borrowing. Yet others were aware that there was a possibility that a shortfall might occur, but expected this to be minor, and some others had kept track of the shortfall but did not have a plan to deal with it.

Those who had not continued to pay into their endowment vehicle had typically let payments lapse on affordability grounds or because media comment on endowment shortfalls had led to individuals believing that their investment vehicle was not worthwhile. In the latter case borrowers did not necessarily understand that the payments they were making to the mortgage provider were not reducing the capital owed.

> *'Everyone said they was not going to pay out so we just stopped paying it. Didn't seem a lot of point carrying on.'*

In some cases where endowments had lapsed there was a clear recognition that this would leave borrowers owing the entire capital sum at the end of the term. In other cases, individuals did not understand that their mortgage had effectively become interest-only, with some thinking that allowing the investment vehicle to lapse would leave them with a shortfall at the end of the term – but without appreciating that none of their mortgage payments were reducing the capital borrowed. In these cases, individuals tended to see their investment vehicle as building up a lump sum that they would realise at the end of the mortgage term rather than as the vehicle for capital repayment.

> *'When I got made redundant we couldn't afford it so I let it go. You know, we focused on getting the mortgage paid. Getting extra at the end was a luxury we didn't need.'*

3.5 The drivers of mortgage borrowing into retirement

For many older borrowers, mortgage borrowing arrangements predated both the financial crisis and the MMR, which has constrained mortgage lending to older borrowers. Thinking around mortgage borrowing into retirement and decision making at the point of taking on a mortgage for these borrowers is therefore rooted in the now bygone era when older borrowers had relatively easy access to mortgage borrowing and interest-only products were widely available.

Research into mortgage borrowing and claiming Support for Mortgage Interest in retirement

A significant proportion of older borrowers have mortgage terms stretching into retirement, with mortgage terms past the age of 65 increasingly normalised in the years prior to the financial crisis in 2007/08 and the MMR of 2010. In that year, the CML data suggests that by 2010, 54 per cent of borrowers over 50 claimed to have a mortgage term stretching past age 65. A further 63 per cent of over 50s either have or wanted their next mortgage to stretch into retirement[8], with this rising to 74 per cent of borrowers in their 60s. However, in most cases, mortgages are due to be repaid shortly after retirement, with 80 per cent of mortgages stretching into retirement due to be repaid before the borrower turns 70.[9]

The same data suggests that there were big differences between the better and less well-off in their motivations for borrowing into retirement. For some, largely the better off borrowers, borrowing into retirement is a strategic decision taken with a view to maximising funds available in retirement and quality of life in both mid and later life. Such borrowers will tend to have other assets and options. For other less well-off borrowers and those having families late, taking mortgage borrowing into retirement is primarily a matter of affordability and lack of capacity to repay prior to retirement.

The qualitative research with low-income, older mortgagors confirmed this perspective and suggested that for such mortgagors setting the mortgage term past the age of 65 has been driven by pragmatic affordability considerations in the same way as choice of interest-only products. The extended term is chosen because it reduces monthly debt service to a manageable level.

For those who recognise that they may need to sell their home to repay the capital, an extended term puts off the requirement to repay the capital and provides greater flexibility in the timing of housing choices (such as downsizing) and how and when to repay the capital. This is particularly a feature for those who intend to rely on an inheritance to repay capital, the timing and scale of which is inherently uncertain.

> *'It goes till I'm 70, which is far too old to be paying a mortgage but … there's no nice way to put this, my wife's parents are already very elderly … and they are unlikely to be still with us in 13 years' time but that gives a reasonable margin for error – if they don't leave it to the cats and dogs home.'*

For some, the calculation simply was that the longer the term, the greater the opportunity to benefit from house price inflation when finally forced to sell when capital repayment was due.

> *'I just think properties always go up … At the time I was just keeping my options open. So I just thought the extra five years they would increase again. Obviously, the interest-only, you've got to pay it off, but what is left over would give me a little more.'*

In most cases, terms are set only a few years into what would have been state retirement age at the point the mortgage was taken out and reflects a change in wider expectations about extended working life and an acceptance that individuals will need to work for longer to accommodate mortgage payments. Most of those on low incomes still making mortgage payments thought in terms of a phased retirement, reduced working hours and working for as long as possible.

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8 The relevant question text referred only to 'in retirement' and did not specify an age for retirement.

9 Source: CML.

> ‘It was just if we could stretch it a few more years which would just give us a little bit more time here but just so we could carry on working and we’re both reasonably fit and well and I think it’s called muddling through.’

There was a sub-set of older mortgage borrowers who had terms stretching into their eighties. Typically, these were late divorcees, those whose partner had died or whose plans had been derailed by the onset of disability. In these cases, taking on a greatly extended mortgage term was part of having to make a new life and take on new mortgage arrangements at a late stage in life.

> ‘I’m 69 now (recent divorcee) and it goes till I’m 85 … so it’s a while before I have to worry about it … it maybe that my children fancy taking the rest of the mortgage and renting the place or letting me live here until I pop off. And then they would have the house.’

3.6 Capacity to service mortgage debt in retirement

The CML data suggests that the majority of low-income mortgagors are confident that they can service mortgage debt in retirement. However, there is a sub-set of mortgagors in the lowest 50 per cent of income over 55 that are either ‘not very confident’ (13 per cent) or ‘not at all confident’ (12 per cent) that they can do so. Those who have interest-only mortgages are less confident than low-income older mortgagors as a whole, with 12 per cent being ‘not at all confident’ and a further 24 per cent being ‘not very confident’ that they can service mortgage debt in retirement.

Just 47 per cent of interest-only borrowers who will be servicing mortgage debt in retirement are confident that they could demonstrate to a mortgage lender that they will have the means to service mortgage debt in retirement (post-MMR a condition of new mortgage borrowing) compared to 72 per cent of older low-income mortgage borrowers overall.

The qualitative research with older low-income mortgagors suggested that interest-only borrowers were more concerned on this score, primarily because they were less likely to be in secure employment and were more likely to be among the lowest paid.

> ‘It does worry me but I try not to think about it, to be honest with you. How we are going to afford the payments. But you just got to put that first and we are both just going to have to keep on in work and, God-willing, we’re both in good health, you know.’

3.7 Attitudes to using property wealth and downsizing in retirement

The CML data explored various aspects of how people thought about property wealth and its role in financial planning in later life.

Paying off the mortgage by retirement age continued to be seen by the majority as the ‘gold standard’ for security in retirement, but was regarded by many, particularly those on lower incomes, as unachievable in practical terms.

The CML data suggests, however, that almost half (46 per cent) of low-income older borrowers do not see making mortgage payments to repay capital past working age and into retirement as problematic, agreeing with a statement that '*as long as you can afford to pay your mortgage, I don't see having to pay a mortgage in retirement as a problem*'. A little short of half (45 per cent) of all home owners over 55 with mortgages stretching into retirement would not be in a position to repay the capital by retirement age in any case.

However, a third of older borrowers (33 per cent of over 55s) saw the model of paying off a mortgage and being asset rich but relatively income poor as outdated and rather took the view that '*Paying out for years only to have most of your wealth tied up in your house in retirement doesn't make sense to me*.'

The CML data also suggests that the thinking of older mortgage borrowers taking on mortgage debt into retirement and their thinking around the utilisation of property wealth in later life has hinged on the notion that easy access to credit and the ability to borrow into retirement would remain a feature of the mortgage landscape.

Many older borrowers would wish to stay in their own homes. However, some 32 per cent of all mortgagors over 55 and with mortgage terms stretching into retirement would want to move home, as would 29 per cent of their counterparts in the lowest 50 per cent of household incomes. Some 47 per cent of all home owners with mortgages stretching into retirement and over 55 claim to intend to downsize on retirement, with 52 per cent of mortgagors over 55 in the lowest 50 per cent of household income intending to do so, rising to 61 per cent of low-income interest-only borrowers[10]. The qualitative research among older low-income mortgagors suggested that there were significant geographical differences in low-income borrowers' ability to downsize or leverage their property wealth. In high growth areas in both the South East and parts of the North and Midlands, respondents had built up sufficient equity to support a range of options. In other areas where respondents had benefited less from capital appreciation, downsizing was often felt not to be an option while in some of the most deprived and 'failing' areas, particularly in run-down, depopulated estates in inner cities, some home owners were struggling with negative equity.

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10 The Financial Conduct Authority (FCA) noted, however, in their 2013 thematic review of interest-only products that borrowers over-estimated their capacity to repay and the feasibility of downsizing. GFK survey data undertaken to support the thematic review suggested that while 37 per cent of interest-only mortgagors believed that they might not have sufficient funds to repay their capital while modelling of capacity to repay suggested that close to half (48 per cent) might be in this position. GFK for FCA, consumer strategies for repaying loans at the end of the mortgage term, 2013.

Many older borrowers intending to downsize also have substantial equity in their home. The better off, however, are much more likely to be able to do so without requiring mortgage borrowing than the less affluent. The CML data suggests that, at 2010 values, ABC1s[11] over 50 and intending to downsize had average net housing equity in 2010 a little in excess of £250,000 on property averaging close to £334,000 compared to net housing equity of a little less than £140,000 on average property values of £206,000 in 2010 for their C2DE[12] counterparts.

When thinking about moving or downsizing, however, improving the quality of life by moving to a nicer area of a different region appeared to be more important to older borrowers than paying off their mortgage. The most commonly cited reasons for moving (respondents could select more than one response) were moving to a smaller property (chosen by 35 per cent of would-be movers/downsizers in retirement), releasing funds to enhance retirement (33 per cent), moving to a nicer area (20 per cent), moving to a different region (19 per cent), all of which were chosen more often than paying off the mortgage (chosen by 16 per cent as a reason to move or downsize).

3.8 Expectations on the future of mortgage borrowing in retirement

Some 72 per cent of all mortgagors over 55 intending to downsize expect their downsized property to be cheaper than their current home. These older mortgagors are not expecting to downsize mortgage-free, however, rather they are expecting to borrow again into retirement, but with either a smaller or similar value mortgage to finance the downsized property. Some 44 per cent of all intending downsizers in retirement over 55 and 39 per cent of those in the lowest 50 per cent of household incomes expect their mortgage to be ‘a lot smaller’ while 20 per cent and 28 per cent respectively expect their mortgage to be ‘a little smaller’. Some 20 per cent and 28 per cent respectively expect their mortgage to ‘be about the same’. Given that mortgage borrowing, at 2010 values, averaged a little over £83,000 for ABC1s over 50 intending to downsize and £67,000 for their C2DE counterparts, this still implies a significant appetite for mortgage borrowing among older downsizers, albeit at a reduced level from their current exposure.

Mortgage lending to older borrowers has in fact fallen steeply after the financial crisis. Lending to the over 65s accounted for just £1 billion or 0.5 per cent of all new mortgages in 2014.[13] It is not clear, however, the extent to which this has been driven by changes in supply or by reduction in demand.

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11 The ABC1 socio-economic group are broadly defined as professionals and managers, and skilled supervisory or clerical white collar workers. The share of ABC1s referred to is thus a percentage of all professionals and managers, supervisory and clerical workers taken together.

12 The C2DE socio-economic groups are broadly defined as skilled, semi-skilled and unskilled manual workers and those on benefits or low paid casual workers. The share of C2DEs referred to is thus a percentage of all skilled manual workers, those on benefits and low paid casual workers, taken together.

13 Source: FCA.

The CML data suggests that, at least prior to 2010, older mortgagors planning to borrow into retirement have seen property wealth as an asset to be leveraged to enhance their lifestyles and for some their thinking has depended on having access to mortgage finance in later life. The qualitative research with low-income mortgagors in 2016 also suggests a continuing expectation of being able to extend mortgage terms or remortgage at the end of a mortgage.

While these plans may have been viable prior to the MMR, it would seem that for many of these older borrowers, these intentions are unlikely to be realised in a post-MMR world, where few will meet the new affordability criteria. The recent pension reforms which will make it more difficult for lenders to reliably assess affordability for borrowers of retirement age and beyond, will likely also act as a further barrier.

Individuals on lower incomes may well be faced with a choice of not downsizing and keeping with their existing mortgage until the end of term or of downsizing, where this is feasible, without mortgage borrowing. The issue of how interest-only borrowers will face the challenge of repaying their capital at the end of the term is the focus of the following chapter.

3.9 Attitudes to alternative market solutions – equity release and life-time mortgages

Against this background, both the CML survey and the qualitative research with low-income older borrowers sought to understand how far older borrowers approaching the end of the mortgage term might be receptive to alternative market solutions, such as equity release and lifetime mortgages.

The CML survey found that, in 2010, a significant minority were attracted to lifetime mortgages as a means of supporting their retirement, even though they recognised that this approach would significantly reduce or even eliminate the value of any equity in their property by the time of their death. More than half (53 per cent) of mortgage holders found the concept at least somewhat attractive, and 11 per cent thought that the idea of lifetime mortgages was very attractive.

The qualitative research with low-income older borrowers found some awareness of equity release among older borrowers with the principle of being able to release equity to enhance later life inherently attractive to many, as was the idea of having ‘sorted’ their financial affairs.

> *‘Well the fact that you don’t have to die before the end of the mortgage term. As you get older the lifetime thing is more important. And it’s basically, I suppose, it comes down to some kind of security. Everything is settled. You don’t have to concern yourself … and you could maybe get a lump sum out. It’s tempting.’*

> *‘So you can enjoy life in your later years, which is vital, rather than, well, we’ll have to stay in because I can’t afford that. It releases a bit more money so you can enjoy life … as long as you can put a barrier around something which can be left to people.’*

However, there was little understanding of how the concept worked in practice and the poor reputation of the sector and the providers operating within it has resulted in widespread mistrust. In the case of both equity release and lifetime mortgages, lenders were thought to take over the property and home owners were seen to lose control of their destiny. As a result these providers were seen exploitative – and even predatory.

> *'The percentage he* [uncle] *is having to pay them for the equity release of half his house is phenomenal … I wouldn't do that because it doesn't become your house and the interest they get is unbelievable. So I wouldn't do it.'*

Products were seen as poor value and people felt that children would be left nothing or less than the parent would wish on their death. Alternatively some believed that there was a risk that children would be saddled with debt. As a result these products were seen as the last resort of the desperate.

Lifetime mortgages and equity release still represent a very small part of the mortgage market, accounting for less than one per cent of new borrowing, albeit that there has been strong growth in lifetime-mortgage borrowing recently, with lifetime mortgages accounting for around half of all borrowing by the over 65s in 2015[14], though it is not clear whether this growth has been driven by a lack of access to mainstream mortgage borrowing or by genuine demand for the lifetime product.

14 Source: CML Findings of Retirement Borrowing working group. Retirement Borrowing, realities, perceptions projections and potential, April 2016.

4 Interest-only mortgagors and repayment of capital

This chapter draws on both the Council of Mortgage Lenders (CML) data and the qualitative research focused on older low-income mortgagors. It discusses understanding of the implications of the need to repay capital at the end of the mortgage term, capacity to service debt and repay capital and how interest-only borrowers plan to repay their capital at the end of the term. It discusses how the planning of the current generation of older interest-only borrowers compares with that of interest-only borrowers who have repaid their capital in the past. It also explores the coping strategies of the low-income interest-only borrowers approaching the end of the mortgage term without capacity to repay and discusses the position of those who have yet to understand the requirement to repay capital at the end of an interest-only mortgage term.

Key messages

- A large majority (84 per cent) of older interest-only borrowers recognise that there is a requirement to repay capital at the end of the mortgage term and most of these have some form of strategy in place.
- Historically interest-only borrowers have been almost as effective at repaying capital as capital repayment borrowers.
- Some 42 per cent of interest-only borrowers have an investment vehicle in place to repay their mortgage. However, just 29 per cent are relying on an investment vehicle to do so.
- The repayment strategies of the current generation of older interest-only borrowers rely less on mortgage-linked investment vehicles than historically (29 per cent compared to 33 per cent for those who have paid off interest-only mortgages historically) but are not very different to those that have been successful for interest-only borrowers who have paid off their capital successfully in the past.
- Almost a quarter (24 per cent of older low-income interest-only borrowers) plan to sell and 22 per cent to downsize (in some cases with or without mortgage borrowing) while 13 per cent intend to repay capital with inheritance. Almost one in five (18 per cent) plan to gradually reduce the mortgage as they have funds available, with many low-income borrowers having relatively low balances.
- Where balances were small, and borrowers had been in reliable employment, borrowers appeared to have savings and other means to support capital repayment of small sums. Where mortgage borrowing was relatively recent, however, balances tended to be higher, albeit mortgage terms were longer, and repayment was much less likely to be achievable without sale of the property.
- Although timing and scale is uncertain, expectations of inheritance appear well-founded and inheritance has played a role historically in paying down interest-only borrowing, accounting for 20 per cent of interest-only mortgages that have been repaid.

- There is a sub-set of interest-only borrowers who are approaching the end of the mortgage term and who remain unworried about it because they do not understand that their preferred strategy of extending the mortgage term (intended by 16 per cent), remortgaging or downsizing and taking on new mortgage borrowing, may not be viable because of the new responsible lending requirements of the Mortgage Market Review (MMR), which few low-income older borrowers will now be able to satisfy.
- There is also a sub-set of both interest-only borrowers (a little less than one in five low-income older interest-only borrowers[15]) and of endowment borrowers who do not understand the nature of the product they have bought and who appear not to appreciate the risk that they will lose their home at the end of the mortgage term. These are also the borrowers least likely to be able to service their mortgage debt in retirement and most likely to be wholly dependent on state pensions, some of whom will also be those most likely to claim Support for Mortgage Interest (SMI).

4.1 Understanding of the implications of the need to repay the capital at the end of the mortgage term

Both the secondary analysis of the CML data and the qualitative research with low-income mortgagors explored how far interest-only mortgagors understood the interest-only product and the need to repay capital at the end of the term. As was noted in Chapter 3, which discussed the dynamics of mortgage product choices, a large majority of older low-income borrowers (82 per cent of over 55s with interest-only mortgages) understand that at the end of an interest-only mortgage term, the sum originally borrowed remains outstanding.

The qualitative research also indicated that many understood that capital needed to be repaid at the end of the term.

> *'My understanding is you get your statement. This is what you owe and that's it. So then it has to be settled.'*

It appears, however, that even where they understand the concept, interest-only borrowers may be less clear about the implications and consequences of the capital sum remaining outstanding at the end of the term. Around six in ten (63 per cent) of all low-income interest-only borrowers (and 61 per cent of the over 55s within that group) recognise that '*if you reach the end of the mortgage term and you do not have the means to repay the capital, you will need to sell the property if you cannot remortgage*'. However, 25 per cent did not know and 12 per cent thought this does not apply. The equivalent data for the over 55s is 22 per cent and 18 per cent respectively.

[15] Eighteen per cent of interest-only borrowers surveyed for the CML in 2010 did not understand that at the end of the mortgage term they would still owe the lender the original capital borrowed.

Similarly, 69 per cent of all low-income interest-only mortgagors (and 61 per cent of the over 55s) agree that '*if you want to pay off an interest-only mortgage, you need to have invested in an alternative repayment vehicle*' while 21 per cent did not know and ten per cent thought this was not the case. The equivalent data for the over 55s is 25 per cent and 14 per cent.

Some of those claiming not to know or to disagree with the notion that the capital will need to be repaid at the end of the term or that borrowers will need to sell their home if they do not have an investment vehicle with which to repay their borrowing, will be among those who genuinely do not understand the nature of the interest-only product. Others may simply be resistant to the idea of an enforced sale and yet others will have alternative repayment plans that are not predicated on an investment vehicle, such as accumulated savings, gradual overpayment or the prospect of inheritance. However, this data would seem to imply either that a number of respondents have not made the connection between the balance being outstanding at the end of the term and the risk of losing their home, or that they believe that they will have options other than selling their home at the end of the mortgage term if they do not have a repayment vehicle in place.

Both the qualitative and quantitative research with low-income interest-only borrowers suggest that there is a sub-set of borrowers who do not have an investment vehicle, savings or other assets in place to repay the mortgage, but who nonetheless believe that they will have other options, primarily taking on a new mortgage on a smaller property or remortgaging or extending the mortgage term on their existing property.

The qualitative research provides some nuance around the thinking of those who do not understand the interest-only concept. These mortgagors either imagined that their mortgage was payable on a permanent basis or, alternatively, looked forward to the end of the mortgage term because they believed that they would at that stage have paid in full for their property. Some had confused the interest-only concept with the 'interest-free' concept commonly used in hire purchase and catalogue sales. In none of these cases was there any sense that the borrowers risked losing their home at the end of the mortgage term. Generally, these borrowers were the poorest and most disadvantaged and those most likely to be dependent on state benefits in retirement.

> *'I've got one of those interest-free ones … They'll have to carry me out of here in a box. I love my house … Luckily for me the* [interest-only] *mortgage finishes in about three years and I'm planning to spent that little bit of extra money I'll have each month on treating my grandchildren.'*

> *'I've not really given it much thought to be honest. I think you get to the end* [of interest-only mortgage term] *and then it's yours and you don't have to give them no more payments.'*

In some cases, these borrowers had not been involved or only peripherally involved in the original mortgage decision, which had been made by partners or ex-partners.

As discussed in Section 3.4, there were also some endowment mortgagors who did not fully appreciate that having let their investment vehicle lapse or not having put one in place in the first place, they were effectively paying an interest-only mortgage. Some of these borrowers had no understanding that their mortgage payments had not paid any of the capital, so the sense was rather of the expectation of a small 'shortfall' and little or no appreciation of the reality that the original sum borrowed would still be payable in full.

'I just don't think that far ahead. Live for today is my motto … I'll worry about that when I get there. There may be a little bit still to pay [on a decades old endowment mortgage with no repayment vehicle] *but we should be there or thereabouts.'*

4.2 Plans for repayment of mortgage borrowing at the end of the term

Both the quantitative data and the qualitative research with low-income older mortgagors revealed a wide spectrum of attitudes to reaching the end of the mortgage term and the requirement to repay capital, depending on how well placed the borrowers were to repay the capital and how far they understood the likely process and outcome, were not in a position to repay the capital in full. The majority of respondents were relatively sanguine on the prospects for repayment, however.

One of the major concerns of regulators and policy makers has been the large number of interest-only borrowers without repayment vehicles and the prospect of these borrowers facing loss of their home when they reach the end of the term. The CML data suggest that only a minority of older (55+) low-income interest-only borrowers have a formal repayment vehicle in place to repay their capital at the end of the term and that even fewer are still paying into it.

The secondary analysis of the CML data suggests that one in ten (ten per cent) have a vehicle which is formally linked to the mortgage and which was arranged with it. Almost a third (32 per cent) have a repayment vehicle which is not formally linked to the mortgages. However, it is important to note that just around three in ten (29 per cent) of older interest-only borrowers intend to pay off their capital at the end of the mortgage term with an investment vehicle. Of those intending to use an existing repayment vehicle to repay their interest-only mortgage, a little over two-thirds (67 per cent) would be able to evidence having the means to do so while a further 16 per cent claim that they will be able to do so at the point of retirement. Of these repayment vehicles, 52 per cent are endowments and 38 per cent Individual Savings Accounts (ISAs) or pension policies. Half (50 per cent) of those with repayment vehicles have paid into it consistently since inception, with 14 per cent increasing their payments. Just 57 per cent of those with an investment policy intended to repay their mortgage believe, however, that their investment is on track to repay their capital.

While the data gives cause for concern, in that it suggests that there is potential for a significant proportion of older borrowers to reach the end of the mortgage term without an investment vehicle in place to repay the capital and that many may find their investment vehicle falling short, it is useful to see this phenomenon in context.

In thinking through the potential for repayment issues, it is important to note that historically, there has been little difference between interest-only and capital repayment borrowers in the proportion of borrowers who repay their capital at the end of the mortgage term. Of all those who had paid off a mortgage in the nationally representative sample of home owners who had done so in the CML survey, 35 per cent had done so on an interest-only basis with a linked endowment, pension or ISA, 34 per cent had done so with a capital repayment mortgage, 15 per cent had paid off a mix of mortgage borrowing interest-only with no investment vehicle and capital repayment borrowing and 12 per cent had paid off an interest-only mortgage which had had no linked investment vehicle, while three per cent claimed to have paid off some other form of mortgage.

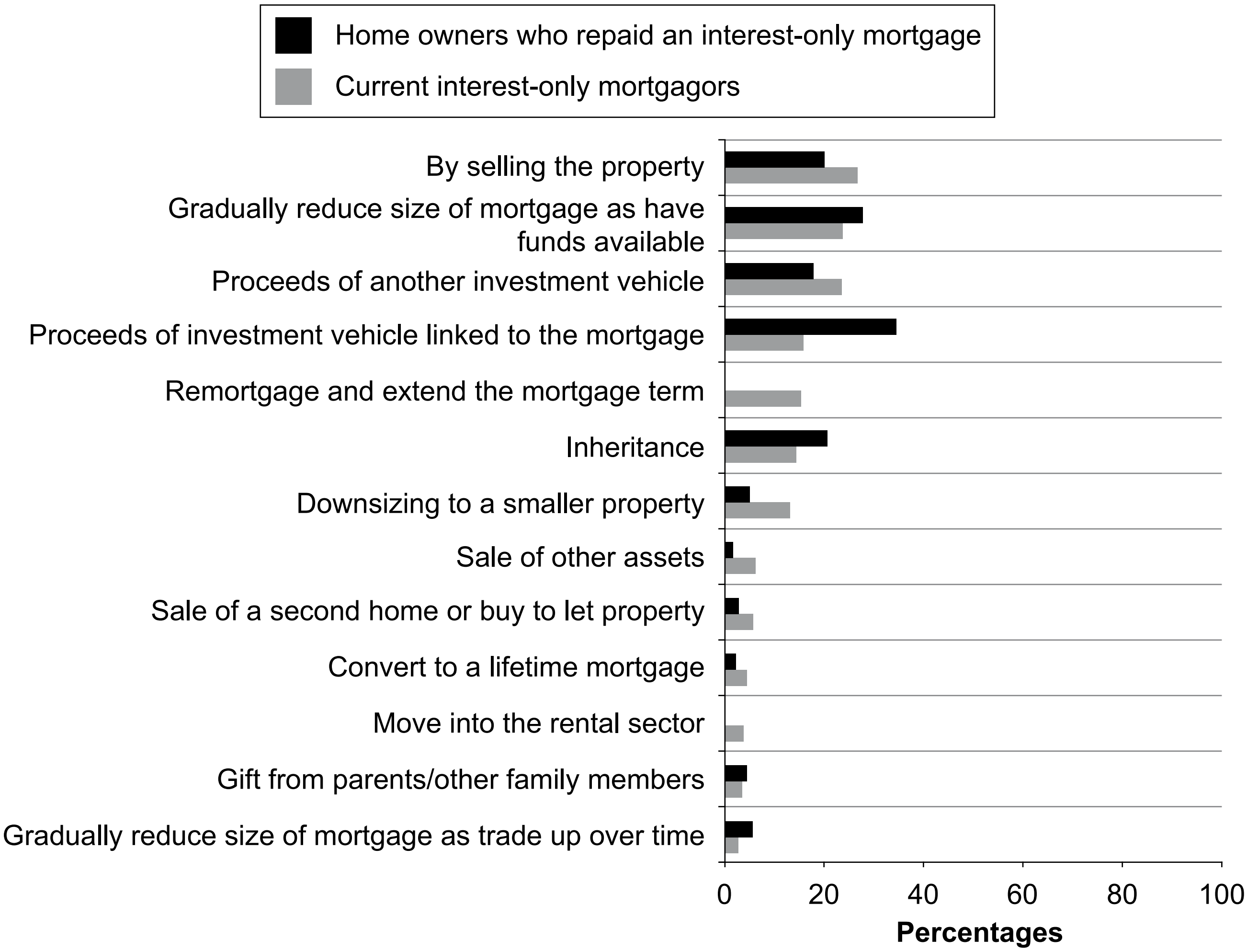
Mortgage-linked investment vehicles have been the most important source of capital repayment of interest-only mortgages in the past, but nonetheless have accounted for only a minority of interest-only mortgages that have been repaid.

It is instructive therefore to examine how those who have paid off interest-only mortgages have done so in the past and to compare these outcomes to the stated intentions of current interest-only borrowers. Historically, interest-only borrowers have relied on a variety of strategies to repay capital. Endowments linked to mortgages and other investment vehicles have been prominent in repayment methods historically (accounting for 33 per cent of mortgagors who have repaid their interest-only mortgage) but gradual overpayment or lump sum payments over time as circumstances allowed have accounted for 27 per cent of interest-only mortgages that have been repaid while inheritance has accounted for 20 per cent. Almost one in five have repaid their interest-only mortgage via a property sale (19 per cent) and, almost as many (17 per cent) have been paid from the proceeds of some other alternative investment vehicles.

The secondary analysis of the CML data suggests that the current generation of older, low-income interest-only borrowers are slightly less likely to think in terms of repayment with a mortgage-linked investment vehicle (19 per cent) than those who have repaid interest-only mortgages historically. Borrowers planned to repay their capital with alternative savings or investment vehicles (19 per cent), by selling the property (22 per cent), reducing the mortgage over time (19 per cent), downsizing and using the funds released to repay the mortgage (14 per cent), and utilising inheritance (13 per cent). However, as can be seen in Figure 4.1, the overall shape of the current generation of older interest-only borrowers' plans for capital repayment is not very different from those which previous generations of interest-only borrowers have successfully employed historically.

Low-income, interest-only, older borrowers' plans are not dissimilar to those of all older interest-only borrowers, albeit that they are less likely to look to inheritance. Almost three in ten (29 per cent) plan to repay their capital using savings or the proceeds of a non-mortgage linked investment vehicle. Around a quarter (24 per cent) plan on selling the property or downsizing to a smaller property (22 per cent). In some cases, selling would leave individuals with sufficient residual equity to support downsizing to another property, but others would require further borrowing to do so. Almost one in five (18 per cent) plan on gradually reducing the size of the mortgage as they have funds available. Some 16 per cent plan to extend the mortgage term or remortgage when their current term comes to an end. Worryingly, however, 16 per cent have no specific plans or don't know how they are going to repay their capital. Just four per cent plan to move into the rental sector.

Figure 4.1 Intended plans and realised plans for interest-only mortgagors



Base: 419 Current interest-only mortgagors. 183 Home owners who repaid an interest-only mortgage. 385 Home owners who had paid off their mortgages.
Source: CML research 2010.

The qualitative research with low-income interest-only mortgagors broadly reflected this picture, but added further nuance around thinking. Mortgage borrowing was for the most part low relative to their equity (outstanding balances lay in the £5,000–£50,000 range, most typically in the £20,000–£30,000 range). Most of these borrowers were confident that they could repay, either from accumulated savings, help from grown up children and in a couple of cases, a pension pot.

> *'I'm almost there. £12,000 in my savings and my redundancy and my daughter is going to help me, she's got a good job, and so I think I'm going to be alright.'*

Those who planned to sell their property at the end of the term, typically the less well off, faced the prospect of doing so with varying degrees of reluctance or enthusiasm. Some looked forward to the prospect of selling and releasing some capital while others viewed the future with trepidation.

> *'There'll be no problem with the house sale. I'm 100 per cent confident of that … and you know, we don't need this big place with the children gone. We'll be OK. We may do it sooner than that* [end of mortgage term]*.'*

> *'Oh God, I'm dreading to think really … probably think about selling it maybe to pay it off. I don't know to be honest. It's a bit scary really, thinking about it … at the moment I'm over the road from my daughter. My children's bedrooms are now my grandchildren's so I would not want to move from here.'*

For those who were worried about being forced into the rental sector, this was often a matter of considerable anxiety because rental payments tended to be significantly more expensive than existing mortgage payments and because mortgagors feared having to move away from family and friends due to being unable to afford local rents.

> *'Look at the rental prices. I'm paying £200 a month, admittedly interest-only, but in the same circumstances if I rented, I'd be paying £450 a month.'*

Generally, among those who intended to downsize, this would seem a realistic strategy in that housing circumstances would appear to allow for this route. It would appear that most older mortgagors intending to downsize do have the capacity to do so in that most live in larger accommodation than they need. Among all those intending to downsize, 44 per cent had four or more bedrooms while 41 per cent had three bedrooms. Some 85 per cent were living in a detached, semi-detached or terraced house.

Those who intended to pay off their capital with inheritance were also relatively sanguine about the future and the challenge represented by the need to pay off the capital at the end of the term.

This thinking would not seem entirely unrealistic, albeit that inheritance is uncertain and some will see the value of anticipated legacies undermined or even eliminated by care costs. The secondary analysis of the CML data suggests that even among low-income mortgagors, those who are home owners are likely also to have parents who are or were home owners, with around seven in ten (72 per cent), doing so. This is less likely, however, for older home owners and those on the lowest incomes. Around three in ten (31 per cent) of all home owners over 55 have a parent who is a home-owner. This falls to 28 per cent for those in the lowest 50 per cent of household income and to 25 per cent for low-income home owners with interest-only mortgages.

While expectations of inheritance will not be fulfilled in every case, this nonetheless suggests that inheritance may have a significant role to play in supporting repayment of capital, even among those on low incomes. The CML data suggests that 29 per cent of all mortgagors over 55 have already inherited and 16 per cent anticipate receiving a significant inheritance in future. Among those in the lowest 50 per cent of household incomes, the equivalent data was 28 per cent and 14 per cent, with 25 per cent of interest-only borrowers in this income and age range having already inherited and 14 per cent anticipating a significant inheritance.

The qualitative research suggested that in the case of those relying on inheritance to repay their mortgage, mortgage terms tended to have been set way into the future in the expectation that they would at that stage have received their inheritance. Those who had not already set their mortgage maturity data well into the future, imagined that they would have little difficulty in simply extending their mortgage term in the event that they had not inherited by the time they needed to repay their capital.

> *'I was more thinking of how long I would be working for but at the back of the mind you know that you will inherit one day and so if you put it* [mortgage term] *off till you are a bit older, you are taking the pressure off there. I would hate to be in a position where we needed my mum's money and she is still very much with us. You don't want to be thinking in that way.'*

> *'I mean my mum is 83 so she might go on for another ten years, I don't know. You can't put a time on it … we're not waiting for anybody to die but I suppose if my mum were still alive then* [at end of mortgage term in nine years] *what I'd probably do is renew the mortgage term, if I could, and go on a bit longer till the time comes.'*

Some of the older borrowers with larger interest-only balances had either inherited or anticipated that they would inherit in time to repay their capital. Generally, these mortgage borrowers were those who had been in secure employment, earning more or the better off.

Some older mortgagors who have expected to extend their current mortgage – or to remortgage – may now find themselves unable to do so under the more stringent affordability criteria lenders now apply. As a result some may find themselves facing a much more difficult situation than they had envisaged and will potentially be at risk of losing their home. Similarly, some of those whose plans for downsizing are predicated on having continued access to mortgage borrowing may find themselves unable to move or to release funds as they had planned.

In 2010, prior to the MMR changes, 52 per cent of all low-income mortgagors with interest-only mortgages (and around six in ten – 61 per cent of those over 55) believed that '*Even if you couldn't pay off the mortgage at the end of the term, you could remortgage and extend the term, provided you could afford the repayments*'. It is clear from the qualitative research undertaken to inform the design of the CML survey in 2010 and from the qualitative work with older low-income borrowers undertaken to inform this research, that when consumers think about being able to 'afford' their mortgage payments they are not thinking of affordability (on a stress tested, capital repayment basis) as encapsulated in the post-MMR responsible lending requirements. The meaning of the statement with which respondents are agreeing should thus be interpreted in the day-to-day colloquial sense of whether people judge their mortgage payments to be manageable. Just nine per cent of all low-income interest-only mortgagors (and 11 per cent of the over 55s within this group) disagreed.

In the qualitative research with low-income mortgagors, those borrowers who were reluctant to sell nonetheless regarded the prospect of the end of the mortgage term with equanimity, expecting that they could either take on both new mortgage borrowing and an extended mortgage term. In most cases most borrowers had low Loan to Value (LTV) and significant housing equity and assumed that with a proven track record of mortgage payments (albeit on an interest-only basis) they would have little trouble in accessing further borrowing.

> *'I imagine that I will have to ask them to extend the term or even look elsewhere for a new mortgage to take us through.'*

Although many would prefer not to have a mortgage if they downsized, people continued to think in terms of trading down and taking on a new smaller and cheaper mortgage.

> *'I think I'll be working forever and ever, as long as possible and obviously when the term's up then I'll be looking at what we're going to do. Do we stay here? Do we sell up and dress down? How much money is realistically in the property … I might not want to manage a new mortgage, we'll see. I'd rather sell up and dress down if there's reasonable equity … But we may have to have a small one* [mortgage]*, we'll see when the time comes.'*

Respondents in the qualitative research had, for the most part, simply not considered that they might not be able to extend the term of their existing mortgage or take on new borrowing. Similarly, none had considered the possibility of being asked to switch from an interest-only to repayment mortgage were they to do so.

Those respondents who had come up against the stricter affordability criteria now applied to older borrowers, had become aware that options had narrowed and that they might find their options vanishingly few. Typically this awareness had arisen from the reported experience of friends or from media comment.

> *'It's even hard for a young 'un to get a mortgage now so now I think for an older person, I don't think so, because even if you've got 100 per cent health now, and all that, you can't get a mortgage if you're say, over 40.'*

> *'My friend told me she was knocked back and they wanted her to make bigger payments than she is now … so that puts me off.'*

Those who had recognised that they would likely have an issue with repaying their capital had, in some cases, made proactive efforts to address the problem by trying to extend the mortgage term or seeking new borrowing with which to cover the outstanding capital. Following Financial Conduct Authority (FCA) guidance in 2013 which required lenders to communicate early and frequently with interest-only borrowers to encourage borrowers to plan effectively for repayment of capital, lenders have written regularly to interest-only borrowers to do so. The FCA reports, however, that lenders have had a low response from potential borrowers at risk. In the qualitative research most borrowers had not engaged with their lender.

Those who had approached their lender, faced with a realisation that they would not be in a position to repay their capital, appear to have met mixed reactions. In some cases lenders had made a positive effort to restructure the debt and remortgage where feasible within the guidelines and regulatory requirements.

> *'Just went to the building society and said 'Look I can't pay it all off because the endowment hasn't filled it's potential'* [shortfall of £25,000] *and they kindly said they would give me another mortgage but it would need to be a repayment mortgage … now bearing in mind I was 60 odd, they said they could do it for 25 years and I said, hang on, you know, I will be 90. I don't think so, shall we say 15? So they said, yes, we can certainly do that … they didn't try to put stumbling blocks in my path, they just said yes. They accepted that I had a problem and they helped me out.'*

In other cases, lenders had reportedly been unsympathetic, insisting on the sale of the home even where mortgage borrowing was relatively low in comparison to the overall housing equity. Lenders appear unable or unwilling to help some borrowers who will not meet the new stricter affordability criteria.

> *'I went to* [named building society] *and they said I was getting about £6,000 a year to live on and it wasn't enough … and they never suggested they could extend it or anything* [the mortgage term] *and I'm 66 next birthday and I didn't know whether they'd allow me to because they never offered for me to stay here when I went down there.'*

Mortgage decisions and plans on repayment of capital were made in the era of easy credit which preceded the financial crisis and the MMR and appear to have been premised on continuing access to credit in retirement. It appears, however, that the reality is that even where older interest-only borrowers have understood the interest-only concept, they have yet to understand that the potential risk of losing their home at the end of the term has been greatly amplified in the changed mortgage conditions of the current market.

There are a number of issues around the potential for low-income borrowers with interest-only mortgages to be unable to repay their mortgages at the end of their mortgage term. The most problematic issues arise for the group – also those most likely to claim Pension Credit and SMI in retirement – who do not yet realise the position they will be in. Outside this group, however, there is perhaps less reason for concern than the headline numbers of individuals with interest-only mortgages without investment vehicles to repay their borrowing would suggest. Historically, investment vehicles have been the most important, but by no means the only, method that borrowers have used to repay interest-only mortgages and the plans of the current generation of low-income interest-only mortgagors do not appear to be very different from the strategies that have been used to repay interest-only mortgages historically.

The historical context in which borrowers repaid their interest-only mortgages is, however, very different from the mortgage landscape today. It appears that the borrowers interviewed held beliefs about mortgages that reflected a different era when access to mortgage lending was much easier for older borrowers. There would appear to be a sub-set of older low-income interest-only borrowers who still believe that they will be able to address the need to find a large capital sum in their later years by moving to a smaller property and taking on a new mortgage, extending their mortgage term or remortgaging their home. Many of these would-be borrowers are likely to be disappointed in a post-MMR world. Some may be able to handle the much higher mortgage payments associated with the capital repayment product they would now be required to take. Others, however, will be unable or unwilling to do so. Relatively few of those on low incomes will be able to demonstrate to the lenders that they could pass the much stricter affordability criteria based on being able to afford a stress-tested repayment mortgage under the MMR protocols. The likelihood is therefore, that many of those whose current plans rest on either extending their existing mortgage or switching to an alternative lender will be unable to do so.

5 A profile of SMI claimants and the pathway into SMI

Key messages

- Support for Mortgage Interest (SMI) claimants are more likely than mortgagors as a whole to have suffered an adverse life event and associated income shock. It is often this which drives the need to claim.
- SMI has helped claimants who might otherwise have lost their home. In the absence of SMI, most would have had no other alternative means of staying in their home.
- There appears to be virtually no awareness of the existence of SMI or the availability of support for mortgage payments for welfare claimants both amongst older mortgage borrowers and SMI claimants, prior to making a claim. Indeed, people appear rather to assume that the state would be unlikely to support mortgage payments. The availability of SMI appears to have played no role in mortgage decisions or the choice to extend mortgages into retirement.
- Once made aware of the availability of SMI, respondents viewed it positively as a ‘safety net’ in the event of an adverse change of circumstances but not as a reason either to stop work, stop work earlier than they had planned or to change mortgage decisions.
- In five years’ time (based on a simple calculation) there could be some 60,000 new SMI claimants, and this could rise to 68,000 new claimants in ten years’ time. These households will be disproportionately likely to have interest-only mortgages and to have no investment vehicle with which to repay their capital at the end of the mortgage term.
- Jobseeker’s Allowance (JSA) claimants receiving SMI are more likely to move in and out of work, claiming SMI in a way that is consistent with original intention of SMI as short-term support. However, there is a proportion of SMI claimants who are older and have characteristics that suggest that they will be long-term benefit-dependent, paying mortgages past working age – until such time as the mortgage matures or the claimant dies. A relatively high proportion of these claimants do not have repayment vehicles to enable them to repay capital at the end of the mortgage term.
- Younger potential SMI claimants approaching retirement age and with interest-only mortgages or terms stretching into retirement may be relatively well placed to move in and out of work and take on SMI on loan basis. Interest rates rises in the future may present difficulties for some of these borrowers.
- A proportion of older long-term SMI claimants moving into retirement and claiming Pension Credit (PC) will face difficulties as they reach the end of the mortgage term without means to repay.
- Interviewees largely saw the reforms to SMI, in which SMI was extended on a loan basis, as reasonable and fair. Some saw the scheme as a superior quasi alternative to equity release.

The Family Resources Survey (FRS) data provides a basis for profiling SMI claimants and for understanding the mortgage holdings of claimants and potential claimants. This chapter provides a recent history of patterns of SMI claims, a profile of claimants and of their mortgage holdings and seeks to draw out the implications for the future shape of and drivers of SMI claims. It draws also on the qualitative research around claimants' circumstances at the point they claimed SMI and their pathway into SMI.

5.1 The SMI case load

Over the ten-year period from 2004/05 to 2014/15, the total SMI caseload fell by almost a third (31 per cent) from 237,000 to 164,000, with the PC SMI claimant count falling in tandem, a decline of 33 per cent, from 116,000 in 2004/05 to 78,000 in 2014/15. The PC caseload is projected to continue declining, by a further 19 per cent over the period to 2017/18. However, working-age SMI recipients are expected to increase over the same period, so that the overall caseload is projected to fall only slightly (two per cent).

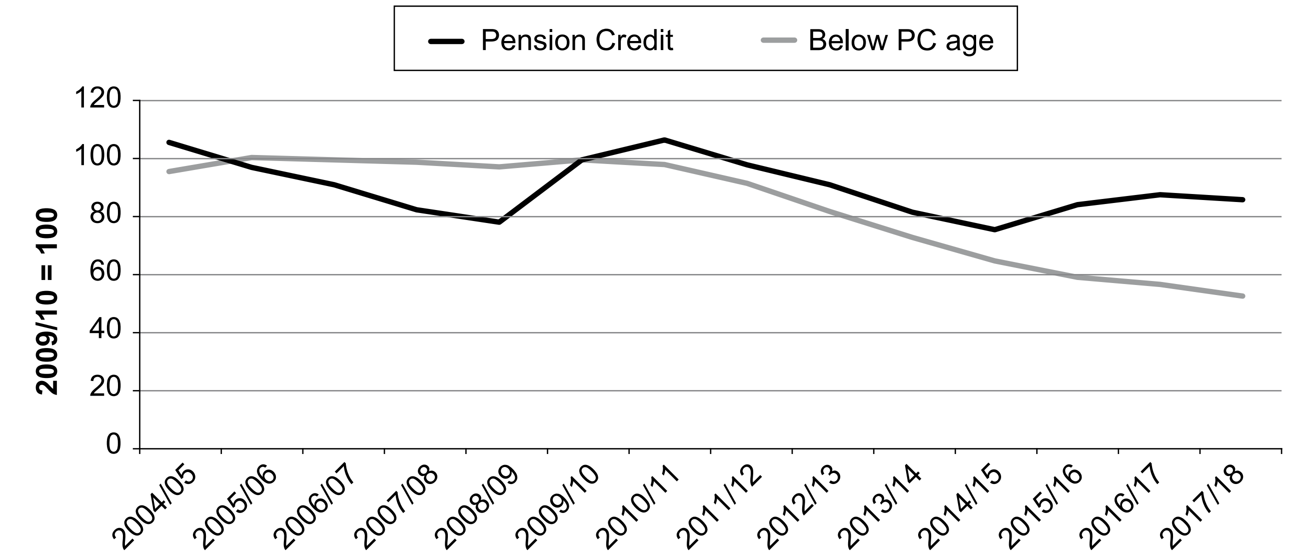
After a period of decline from 2004/05 to 2008/09, the number of working-age SMI recipients increased sharply in the wake of the recession. Since peaking in 2009/10, the number fell through to 2014/15 but is projected to rise slightly over the next three years.

Table 5.1 SMI caseloads: Historical and projected

	000s			Per cent change	
	Historical		Forecast	Historical	Forecast
	2004/05	2014/15	2017/18	2004/05 to 2014/15	2014/15 to 2017/18
Pension Credit and equivalents	116	78	63	-33%	-19%
Working-age benefits	121	86	98	-29%	14%
Of which:					
• Employment and Support Allowance/Income Support sick and disabled	70	53	57	-24%	8%
• Income Support for Lone Parents	28	9	12	-68%	33%
• Jobseeker's Allowance/Income Support for the unemployed	12	15	12	25%	-20%
• Others in receipt of Income Support	11	9	17	-18%	89%
All	237	164	161	-31%	-2%

Source: Benefit expenditure and caseload tables Autumn Statement 2015.
Source: DWP, Benefit expenditure and caseload tables 2015, 30 September 2015 update, available at: https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2015

Figure 5.1 SMI Caseloads by pension age and working age



Source: DWP, Benefit expenditure and caseload tables 2015, 30 September 2015 update, available at: https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2015 SMI Demographics.

The FRS is a cross-sectional survey and therefore can only provide a ‘snapshot’ of SMI recipients at a point in time.[16]

The survey data do not, for example, say why or how SMI recipients came to be in that position. Bearing that caveat in mind, the FRS data illustrate a number of important attributes of SMI recipients. In particular, SMI recipients have a number of distinctive features, whether in retirement or otherwise. Those features point to the role of life-cycle and other transitions which may have precipitated income shocks leading to receipt of an income-based qualifying benefit and subsequent take-up of SMI.

16 In any given year, there are relatively few SMI recipients included in the FRS. For example, in 2013/14, the number of SMI recipients was 65. To provide a profile of SMI recipients, therefore, the survey data were pooled for the years 2009/10 to 2013/14, giving a total sample size of 492. Of those, 203 were aged less than 50, 102 aged 50-59 and 187 aged 60+.

Table 5.2 SMI recipients: Demographics (head of household)

		SMI recipients	Others on a qualifying benefit w/mortgage	All others w/ mortgage
All	All	100	100	100
Age	Under 50	39	39	70
	50-59	22	24	23
	60-69	26	22	6
	70+	13	15	1
Gender	Male	45	51	68
	Female	55	49	32
Family type	Pensioner couple	12	14	4
	Single pensioner	19	16	2
	Couple with children	11	18	41
	Couple without children	12	23	31
	Single with children	18	9	5
	Single without children	28	19	18

Source: FRS pooled data 2009/10 to 2013/14.

On the basis of the cross-sectional data, compared to other mortgagor households, SMI claimant households appear to be more vulnerable and display a markedly higher incidence of transitions that point to the role of income shocks as a route to take-up of SMI. Almost half of SMI recipients have been widowed, divorced, or separated (47 per cent) compared to fewer than one in eight heads in other mortgagor households. Long-standing illness is also more prevalent in SMI households (69 per cent overall compared to 21 per cent of other mortgagor households). Almost two in five SMI claimants (38 per cent) reported that they are not in work because they are sick or disabled.

Table 5.3 SMI claimants

Vulnerability factors relative to other mortgage borrowers				
		All	**50-59**	**60+**
Widowed/divorced/ separated	SMI recipients	47	44	56
	Qualifying benefit, no SMI	32	23	49
	All other households with mortgage	12	18	26
Long-standing illness	SMI recipients	69	73	76
	Qualifying benefit, no SMI	57	64	74
	All other households with mortgage	21	29	45
Not working because permanently sick/disabled	SMI recipients	38	58	33
	Qualifying benefit, no SMI	23	39	33
	All other households with mortgage	1	2	4

Source: FRS pooled data 2009/10 to 2013/4.

This pattern of disadvantage is particularly evident among older SMI claimants relative to both others on a qualifying benefit and other older mortgagors. SMI recipients aged 60 plus are mainly either retired (56 per cent) or permanently sick/disabled (22 per cent), depending therefore on income sources other than employment-related. By contrast, in mortgagor households not on a qualifying benefit, a substantial portion work past 60, either full-time (50 per cent) or part-time (14 per cent). Very few (three per cent) are unable to work because they are permanently sick/disabled.

The qualitative work confirmed the picture arising from the FRS data of individuals claiming SMI being a population with a high incidence of adverse life events and income shocks. A common thread among SMI claimants was a shared history of a downturn in circumstances caused by the onset of disability or a serious illness or divorce and bereavement.

Relatively few saw themselves as being in a position to be able to work again. Some of those who were of working age and claiming SMI had suffered setbacks which implied a temporary withdrawal from work, such as an accident with relatively short-term consequences, business failure, redundancy or loss of employment, but these were in a minority. For other claimants, of both working age and in retirement, the adverse life event they had experienced represented, in their perception, a permanent shift in circumstances meaning that, as they saw it, they would be unable to return to work.

SMI recipients also appear more financially stressed than both others on a qualifying benefit and compared to mortgagors as a whole. They are much more likely than other mortgagors to view their housing costs as a ‘heavy burden’. They are also more likely to say they have had one or more problem debts now or in the last 12 months and to admit to having missed mortgage payments. Their own financial resources are thin; 82 per cent have savings of less than £1,500 and almost three in four (74 per cent) have no employer or private pension or, among those in retirement, are in receipt of State Retirement Pension only.

SMI recipients have typically spent three or more years on their qualifying benefit. Almost two in three SMI recipients (64 per cent) have lived at their current address for ten or more years. They are long-term residents which may affect their ability to respond to the circumstances that have led to the need for an income-based benefit such as PC. For example, longer-term residents are likely to have built ties to their local communities which would inhibit their willingness or capacity to move house as a response to changed circumstances.

Table 5.4 SMI recipients: Years on the qualifying benefit

	Income Support	JSA/ESA	Pension Credit	All
Up to 2 years	24	69	22	36
2 years but less than 3	12	13	14	13
3 years but less than 4	9	1	9	7
4 years but less than 5	2	2	6	4
5 or more Years	43	5	35	29
Not answered	10	9	13	11
All	100	100	100	100

Source: FRS pooled data 2009/10 to 2013/14.

5.2 Mortgages held by SMI claimants

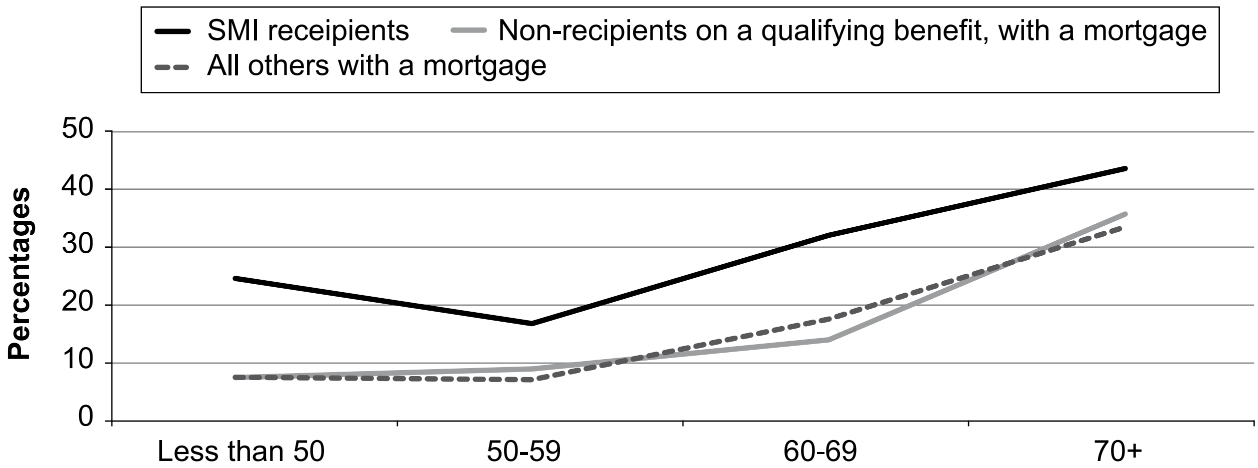
Relative to the general population of households owning with a mortgage, SMI recipients are more likely to have taken out an interest-only mortgage with no linked investment, especially those aged 60 plus, 34 per cent of whom have an interest-only mortgage, compared with 20 per cent of mortgagors aged 60+.

Table 5.5 SMI mortgages: Type

		All	Under 50	50-59	60+
SMI recipients	Repayment	52	61	57	41
	Interest-only, no linked investment	26	24	17	34
	All other	21	15	26	25
Qualifying benefit, no SMI	Repayment	67	79	67	55
	Interest-only, no linked investment	14	8	10	23
	All other	19	13	23	23
All other owned with mortgage	Repayment	76	80	69	54
	Interest-only, no linked investment	9	9	8	20
	All other	15	11	23	26

Source: FRS pooled data 2009/10 to 2013/14.

Figure 5.2 SMI mortgages: Profile



Source: FRS pooled data 2009/10 to 2013/14.

The term structure of mortgages held by SMI recipients does not differ greatly from the general population of households with mortgages, regardless of age group. Within each age group, the years left on the mortgage and the age at which the mortgage ends does not vary greatly between SMI recipients and other households owing with a mortgage, which would imply that the setting of the mortgage terms has not been influenced by any adverse life event which might have precipitated an SMI claim. Equally, after allowing for their older age profile relative to other mortgagors, median loan-to-value (LTV) ratios for SMI recipients do not differ greatly from other households owning with a mortgage. Again, this would imply that LTV ratios have not been influenced by either an adverse life event or the making of an SMI claim.

The older age profile of SMI recipients relative to other mortgagors' results in a median age of 65 at which the mortgage ends, i.e., half of SMI recipients have a term which takes their mortgage past the age of 65.

Table 5.6 SMI mortgages: Term

		All	Under 50	50-59	60+
Term (median, years)	SMI recipients	25	25	25	22
	Qualifying benefit, no SMI	25	25	25	24
	All others	25	25	20	17
Years left on mortgage (median)	SMI recipients	13	18	11	7
	Qualifying benefit, no SMI	12	17	10	7
	All others	17	19	10	6
Age mortgage ends (median)	SMI recipients	65	57	65	75
	Qualifying benefit, no SMI	65	56	64	77
	All others	60	57	64	70

Source: FRS pooled data 2009/10 to 2013/14.

Unsurprisingly, outstanding loan balances for older mortgagors are lower than for their younger counterparts. Among SMI recipients under 50, the median remaining mortgage balance is £70,000, with this falling to £47,000 for SMI claimants aged 50–59 and £25,000 for those aged 60 plus.

When measured relative to their gross incomes, both average loan balances and mortgage interest payments are higher among SMI recipients when compared with households not on a qualifying benefit.

Table 5.7 Mortgage balances and mortgage debt service

		All	Under 50	50-59	60+
Mortgage balances remaining (median loan values)	All SMI recipients	£46,000	£70,000	£47,000	£25,000
	Repayment mortgage	£40,252	£59,632	£42,000	£16,000
	Other	£59,000	£98,000	£58,000	£30,000
Loan-to-income ratio (median, Mortgage balances remaining basis)	SMI recipients	3.4	4.9	4.1	2.1
	Qualifying benefit, no SMI	2.4	3.6	2.6	1.4
	All others	1.9	2.1	1.3	1.1
Mortgage interest payments (% of gross income)	SMI recipients	17	20	20	13
	Qualifying benefit, no SMI	13	15	12	10
	All others	7	8	6	6

Source: FRS pooled data 2009/10 to 2013/14.

The data available from the FRS would suggest that, compared to other mortgagor households, the incidence of ex-local authority properties is higher among both SMI recipients and those on a qualifying benefit but not in receipt of SMI.

On the basis of updated estimates of survey year property values[17], the typical SMI recipient has an outstanding loan equating to 41 per cent of the estimated property value, which is lower than the median for all mortgagor households not on a qualifying benefit (52 per cent). The disparity largely reflects the older age composition of SMI recipients. The question on the FRS relating to whether the property had been rented from a local authority prior to purchase was discontinued after 2009. However, for the years, 2002/2003–2009/10 some 24 per cent of SMI recipients claimed to have purchased their property from the local authority, having previously rented from the authority, compared with 33 per cent of mortgagors on a qualifying benefit and not in receipt of SMI and seven per cent of all other mortgagors.

Table 5.8 provides estimates of the numbers of households aged 65 and over who will have a mortgage in five and ten years' time, and, within this, the numbers who will have an interest-only mortgage with no linked investment vehicle, and the proportion of mortgage borrowers over 65 that will lie in the bottom 20 per cent of household incomes, most likely to be dependent on welfare payments in retirement. This suggests that in five years' time, there could be some 60,000 potential new SMI claimants while in ten years' time that number could rise to 68,000.[18]

Table 5.8 Estimated numbers of mortgages being taken into retirement, based on mortgage terms as reported in FRS

Number of households owning with mortgage, head aged 65+	Baseline (pooled FRS data 2012/13 and 2013/14)	5 years ahead	10 years ahead
All	302,000	394,000	438,000
Interest-only, no linked investment	83,000	98,000	88,000
Bottom 20% of household income	37,000	60,000	68,000

Source: Estimates derived from pooled FRS data, 2012/13 and 2013/4.

17 Source: The Nationwide regional house price dataset 1973 onwards. Purchase amounts and the year of purchase are reported by FRS respondents with outstanding mortgages. The purchase amounts were uprated to the relevant survey years 2009/10 to 2013/14 to estimate ratios of outstanding mortgage balances to property values.

18 The grossed-up baseline of 302,000 households owning with a mortgage where the head is aged 65+ is derived by taking the average of pooled FRS data for 2012/13 and 2013/14. The five years ahead estimate of 394,000 is derived by adding to the baseline those who are aged 60-64 in the baseline, who will age into the population aged 65+, and who have a mortgage term extending past the age of 65. An adjustment is made by subtracting out those mortgages held by the baseline population aged 65+ and which will be repaid within the next five years. By a similar process, adding in households where the head is 55-59 in the baseline and with mortgage terms extending past age 65, yields the ten-year ahead estimate of 438,000 for the number of households with a mortgage where the head is 65+.It must be emphasised that the five and ten years ahead estimates shown in the table are purely indicative, to illustrate the potential growth in the stock of mortgages with terms extending into age 65 and older. They should not be treated as projections.

5.3 Awareness of SMI and the role of SMI in mortgage decision making

The qualitative research with older low-income mortgagors explored both broad thinking around expectations of state benefits and working in later life, how mortgagors planned to service mortgage borrowing in retirement and awareness, expectations of, and attitudes towards, government support for mortgage interest, both in periods out of work and in retirement (see Appendix C for the topic guides).

The concept of a clear demarcation line between working and retirement seems to have given way to a more nuanced expectation of a gradual 'winding down' and part-time work. People still in a position to work were highly conscious of the requirement to work for longer and were largely keen to do so.

> *'I think personally I would work for as long as I possibly could. That's just pride and I've been brought up to whatever you want you pay for … I'd still want to work and pay my way for as long as I possibly could.'*

For some, particularly those on the lowest incomes and in insecure employment, they reported that they would need to work for as long as their health allows.

> *'To be honest with you, obviously I'd like to retire but I can't see any alternative to working as long as my health holds out.'*

The presence of a mortgage that requires servicing was clearly a factor in how long and how hard individuals planned to work for, with many terms set only a few years past traditional retirement age.

> *'Well, I can't see how we could stop working with the mortgage to pay. We're just both going to have to keep on working for as long as we possibly can and hope we can hold out till it finishes.'*

Those on the lowest incomes or insecure employment, those who anticipated being solely reliant on State Pensions and those in ill health were much less positive about the future and much more anxious about how they would service mortgage debt in retirement.

> *'Neither of us have any pensions plans. So we would be on State Pensions. At the moment, I'll be honest with you, we haven't given it a great deal of thought. I don't know what's going to happen … we're just hoping that we can both carry on working for as long as possible, however long that may be.'*

Those who felt that their retirement provision was likely to be inadequate for their needs, had begun to look to housing equity as part of their retirement solution.

> *'I have looked into it actually and when you are young and paying into it there is going to be all this upside and we are all going to be, not rich, but OK, you know, but I've discovered that actually the pension you're actually going to get is miniscule. So I don't know is the answer to your question. I suppose we'll get by, we'll have to, but we may have to look at what our options are with the house.'*

> *'I had a look at the pension forecast and thought 'Oh crikey. I'm not going to get as much as I expected to'. So it may be that we downsize.'*

5.4 The role of SMI in mortgage decision making and expectations of how mortgage borrowing will be serviced in retirement

Attitudes to and expectations of Government support for mortgage borrowing in retirement sits within a wider picture of a lack of awareness and understanding of projected incomes in retirement and of the state benefits available in retirement to those on low incomes and entirely dependent on state benefits.

There was a small sub-set of well-organised respondents who were highly aware of their future entitlements to State, occupational and private pensions. In large part this group were those with most valuable entitlements and with the greatest accumulated savings.

Generally there appears to be limited awareness of the state benefits available in retirement. The majority of respondents appeared to have only a vague sense of what their future income would be in retirement.

> *'Foolishly, I haven't even looked at it. I haven't got a clue … I hope I've still got ten years to work. I'll look at it nearer the time.'*

> *'I haven't really looked into it. I think, you know, there's the state pension and that's about all I know about really. I don't think I'd be able to get anything else. Free bus pass and free prescriptions, but I've got that anyway. Is it seven, eight hundred pound a month? I should know.'*

There was very low awareness of PC and an even hazier sense of the conditions which would entitle claimants to it.

> *'I don't think there is anything else other than your State Pension is there?* [Q. Pension Credits?] *I've heard of, like, tax credits that people get when they're not earning enough. Would it be a bit like that?'*

There was virtually no awareness of the existence of state support for mortgage payments, the format that it might take and of any entitlement criteria.

> *'I don't know to be honest. If you live in a council house you get like, if you're out of a job, you get your council rent paid but the Government don't really do anything for people that own the mortgage.'*

> *'Oh no. If you come out of work, they don't pay your mortgage. So I think it'd be just the same for pensions.'*

Indeed, the near universal assumption was that the state would not support mortgage payments, which were seen as a personal responsibility and not a matter for the state.

> *'I mean, you can't imagine the state would be doing that … where do they get the money to do it? People that are buying their own property, they've made that choice and why should the state help them out?'*

It was quite clear that against the background of lack of awareness of SMI, the availability of SMI has played no role in mortgage decisions. It had clearly not influenced decisions either to take on interest-only mortgages or to borrow into retirement. Most interviewees indeed took the view that knowledge of the availability of SMI would not have changed their mortgage decisions in the past nor would their new knowledge that the benefit was available influence their mortgage arrangements and decisions in the future.

Generally, respondents were pleasantly surprised to learn of the existence of SMI. Individuals felt that SMI covering interest payments but not capital repayment was both reasonable and fair. The view was that the state could not be expected to contribute to investment in privately held assets.

> *'I don't think, now you've told me about that, that it would really make any difference* [to mortgage choices] *… because I'd work for as long as I possibly could. I've never lived off the state. I've always worked. I really don't like the idea of living off the state, do you know what I mean.'*

> *'I would have hoped that we would never have to rely on something like that. We're the old school that you work for everything you get and you shouldn't rely on help at the drop of a hat, do you know what I mean?'*

There was a sub-set of mortgagors on the lowest incomes – those who had no savings or retirement provision other than their expectation of a State Pension – who were greatly relieved to learn of the existence of SMI. SMI was not seen however as a reason to stop working but rather as a 'safety net' in the case of a catastrophic downturn in circumstances.

> *'Well, that is a surprise. It's good to know that there is that bit of a safety net out there if all else fails.'*

> *'How brilliant is this country? You know, paying your mortgage interest, that could be a life saver. But there must be conditions. Do you have to be destitute? They wouldn't pay it forever, would they, I mean if you're not going to go back to work.'*

Some of those with no real prospect of repaying their capital at the end of the term, considered whether SMI might enable them to stay in their home, however. Some speculated whether mortgage lenders might accept SMI as a rationale for extending the mortgage instead of forcing the home owner to sell up.

> *'So maybe there is a little something out there that will carry on and help me keep my house rather than put it on the market.'*

This picture of low awareness of SMI and SMI among older low-income mortgagors was reflected also in the qualitative research with SMI claimants. There appeared to have been very little awareness of the availability of SMI among claimants prior to making their own claim. Indeed some claimants had exhausted savings and reduced spending on other things over an extended period to prioritise mortgage payments before they had learned about SMI.

Some claimants had been in serious arrears and on the verge of repossession before they became aware of SMI. In several cases, mortgages had been switched to interest-only as a crisis measure. No claimants had planned to rely on SMI or had based any mortgage decisions either prior to or after their adverse life event on the availability of SMI.

'It is cheaper to take a mortgage than to pay rent, so to pay the least I could basically, which obviously is now going on till I'm eighty something … and now, given what's happened [stroke] *it's being paid by the Government at the moment … but that wasn't the plan.'*

5.5 The pathway into SMI and the impact of SMI on claimants' lives and housing position

As noted in Section 5.1, SMI claims had almost invariably been triggered by an adverse change in circumstances accompanied by an income shock. The lack of awareness of SMI had meant, however, that claimants had typically struggled for some time before becoming aware that help with mortgage payments was available.

SMI claims appear typically to have been facilitated by advice from Citizen's Advice or Jobcentre Plus or to have been precipitated as a result of intervention following a benefit entitlement check. There were some instances of lender referrals but lender practice appears to vary significantly and the majority of claimants had not been told about the availability of SMI where they had contacted their lender for help.

'I think I went and talked to somebody. My husband had died and I had paid for his funeral and I hadn't drawn any benefits. I didn't even draw Carer's Allowance so I didn't get any help with the funeral … and they told me that I'm eligible for Pension Credit and they would pay towards my mortgage. And I'd kind of used every penny I had in savings by then paying it [the mortgage] *so no, I didn't know about it at all.'*

'I didn't know it was there. And it was a nice surprise when it turned up … The lady down the Jobcentre said, 'Look you might as well apply for everything you can, you've paid into it for long enough' … and so that made me feel a little bit better.'

In all cases, claimants reported that SMI had been helpful in that it had enabled claimants to stay in their home and avert the loss of their home which could have made already stressful and distressing circumstances worse. With the exception of the individuals with sufficient housing equity to downsize and buy outright, a number of respondents would have looked to social housing or the private rental sector for accommodation when facing the prospect or reality of eviction.

'Six months ago it [SMI] *was a life-saver for us. I mean, I was unemployed, my wife was unemployed and she was on disability and hadn't had her pension and we were struggling. In fact we defaulted for four months … and then the mortgage interest payment kicked in.'*

'And I'd be in poverty now. It would have been so difficult. I would have had to sell the house and go and live in a rented flat, if I could pay rent. Basically [without SMI] *it would have ruined the rest of my life.'*

5.6 Response to SMI reform

The research team also explored with respondents how they would view the transformation of SMI from a benefit to a loan, to be repaid by the borrower on sale of the property, return to work or death. Non-claimants saw this move as fair and reasonable, with some interpreting such a scheme as almost a Government-sponsored and low-cost version of equity release.

> *'That actually sounds good … and I think that would give the people who would have to rely on that a bit more dignity because they know they are paying it back … you know, that awful word that gets bandied about … scroungers … well a certain type of person wouldn't want to be associated with that name, so I think that would be quite a good thing, to be honest with you.'*

> *'It's a bit like the equity release … I don't know, it seems to be a bit more comfortable coming from the Government rather than a company. Would they be putting interest on that? I know when you got a loan from the DWP, it's an interest free one … so I'm sure it would be a low interest thing or even interest free basically.'*

SMI claimants had mixed views on the forthcoming reform of SMI. Some claimants regretted the loss of SMI as a benefit on a personal basis, but understood the rationale for it and saw the reform as a reasonable move and exchange for government's support in claimants' acquisition of a personal asset.

> *'If it means I could stay in my house which I really, really would love to do then, that's fair enough and when my children sell the house then, fair dos, they can have it back. I expect they'd want interest, fair dos, as I said, as long as the interest was not extortionate.'*

Among those who felt that the reform was fair and reasonable there were concerns about how it would work in practice. Concerns centred around having to start repaying the loans as soon as an individual entered the workforce or the potential to downsize or realise equity being compromised by the need to repay the loan as soon as the house was sold or re-mortgaged. For married and cohabiting couples in retirement, there were concerns about whether the loan would need to be repaid on the death of one of the partners or whether it could be held over until the death of the second partner.

> *'The concept is sound, you know, the Government don't have a bottomless pit of money … it would depend on the terms of the loan. If it was instantly repayable as soon as you sell your house it could be very difficult for some people so each case would maybe need to be taken on its merits.'*

There were some claimants, however, who saw the move as exploitation of the weakest and most vulnerable at a point in their lives when they really needed help. In these cases the move to change the benefit into a loan was seen as penalising those who were already suffering through no fault of their own.

> *'We didn't ask to be in this position. It's completely out of my control. That is just kicking us when we are already down.'*

6 Mortgage borrowing into retirement: a typology

The research team developed a typology using the qualitative research data which was designed to highlight the need for and propensity to claim Support for Mortgage Interest (SMI) among different segments of older borrowers with mortgage terms stretching into retirement. This typology is described in this chapter.

Key messages

The resulting typology contains seven older mortgage borrower segments:

- Older borrowers with mortgages stretching into retirement which will not require support because they have sufficient resource to address any challenges they face. Some, however, such as those relying on inheritance to repay capital, may face timing issues.
- Claimants with the means and sufficient housing equity to downsize or move as a potential resolution to their problems, though some may be deeply resistant to doing so or unable to raise borrowing to enable downsizing.
- Three segments of older mortgage borrowers which will have a higher propensity to need and to claim for SMI.
- Interest-only borrowers who have no means to repay their capital at the end of the mortgage term, and whose planning for this eventuality has relied on extending their mortgage term or remortgaging. For these borrowers there are currently no market solutions.
- Borrowers unaware of the risks they face as their mortgage matures. Some of these individuals may have the means to resolve their problems. Most, however, have very little in the way of resource. These borrowers are highly likely to be SMI claimants.
- Younger, working-age potential SMI claimants who have typically had an accident or the onset of ill health or disability will have higher mortgage borrowings than other SMI claimants because they are at an earlier stage of the mortgage cycle. As a result they will need a high level of support, in some cases over an extended period. Some of these younger borrowers will be able to re-enter the world of work and resume making their own mortgage payments but some at least, may require long-term support.

6.1 Approach and design dimensions

The typology was mapped across the key axes of propensity to claim SMI, the quantum of support likely to be required by claimants and the length of time for which support was likely to be required. It is intended to capture the nature of need and propensity to need and claim SMI, either temporarily or permanently.

The typology further rests on differences between claimants/potential claimant groups in:

- The degree of disadvantage and relative vulnerability claimants are experiencing.
- Claimants' needs in relation to servicing mortgage debt or repaying capital.

- The nature of the specific challenges claimants face.
- The extent to which claimants have options.
- The potential for claimants to resolve their own difficulties without support.

The resulting typology contains seven older mortgage borrower segments:

- One segment which is unlikely to face issues in servicing mortgage in retirement or in repaying capital.
- One segment which may face timing issues in the short-term on both servicing mortgage debt or repaying capital.
- Two segments which will potentially have the means to resolve issues on servicing mortgage in retirement and repaying capital without support.
- Three segments which are highly likely to need and to claim SMI.

6.2 The typology of low-income households borrowing into retirement and their propensity to need and claim SMI

A typology for low-income mortgagor households borrowing into retirement and their propensity to need and claim SMI: The seven mortgage borrower types.

1. Low risk comfortable planners 2. Inheritance based planners	No/low support needed
3. Equity rich down-sizers 4. Wedded to their home	Potential self-help down-sizers
5. Trapped no options 6. Unaware and confused 7. Victims of misfortune	Disadvantaged, high support needs

Table 6.1 A typology for low-income households borrowing into retirement and their propensity to need and claim SMI

	No/low support needs		Potential self help downsizers		Disadvantaged, high support needs		
Segment name	**Segment 1** Low risk comfortable planners	**Segment 2** Inheritance based planners	**Segment 3** Equity rich down-sizers	**Segment 4** Wedded to home	**Segment 5** Trapped no options	**Segment 6** Unaware and confused	**Segment 7** Victims of misfortune
Needs	None	Potentially none. Possible temporary need for support for debt service. Ability to flex mortgage term.	Potentially none. Possible temporary need for support for debt service if health issues.	Ability to extend mortgage/ permanent remortgage solution.	Ability to extend mortgage/ permanent remortgage solution.	Ability to extend mortgage/ permanent remortgage solution.	Indefinite support for servicing mortgage.
Challenges	Low	Timing of inheritance. Inflexibility of mortgage term.	Barriers to new mortgage borrowing. Poor value equity release products.	Reluctance to move. Barriers to new mortgage borrowing. Poor value equity release products. Inflexibility of mortgage term.	Lack of suitable market solutions. Inflexibility of mortgage term.	Lack of awareness. Lack of suitable market solutions. Poor value equity release products. Inflexibility of mortgage term.	Long-term nature of need and scale of mortgage borrowing.
Self resolution	Yes	Yes, with time	Yes and willing	Yes and resistant	No	Yes and unaware	No

Table 6.2 A typology for low-income households borrowing into retirement and their propensity to need and claim SMI: Propensity to claim SMI and quantum of need, duration of need

	No/low support needs		Potential self help downsizers		Disadvantaged, high support needs		
Segment name	**Segment 1**	**Segment 2**	**Segment 3**	**Segment 4**	**Segment 5**	**Segment 6**	**Segment 7**
	Low risk comfortable planners	**Inheritance based planners**	**Equity rich down-sizers**	**Wedded to home**	**Trapped no options**	**Unaware and confused**	**Victims of misfortune**
Propensity to claim SMI	Very low	Low	Low	Medium	High	High	Very High
Quantum of SMI support required	Very low	Variable	Variable	Low	Low	Low	Variable but can be very high
Duration of need (if required)	Short-term	Short-term	Short-term	Long-term	Long-term	Long term	Very long-term

Figure 6.1 maps the various types against two axes showing their capacity and willingness to address their mortgage and retirement challenges.

Figure 6.1 A typology for low-income households borrowing into retirement: Capacity and willingness to address mortgage and retirement challenges

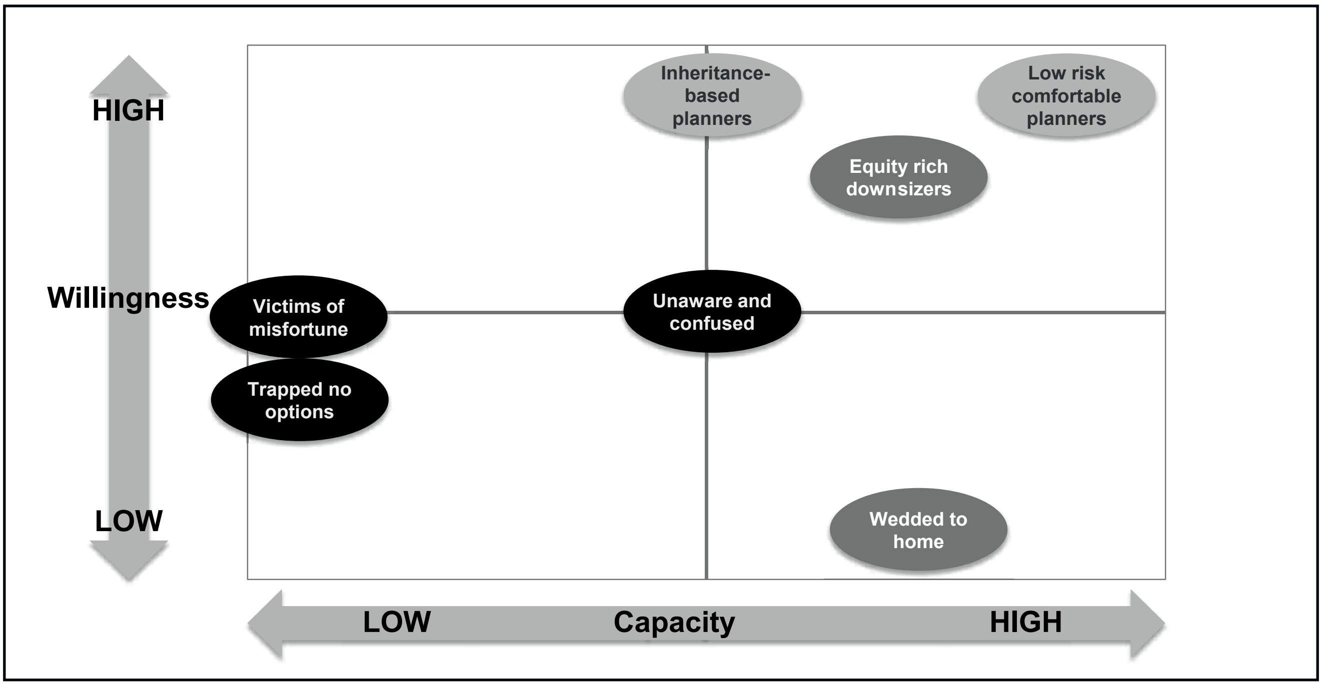
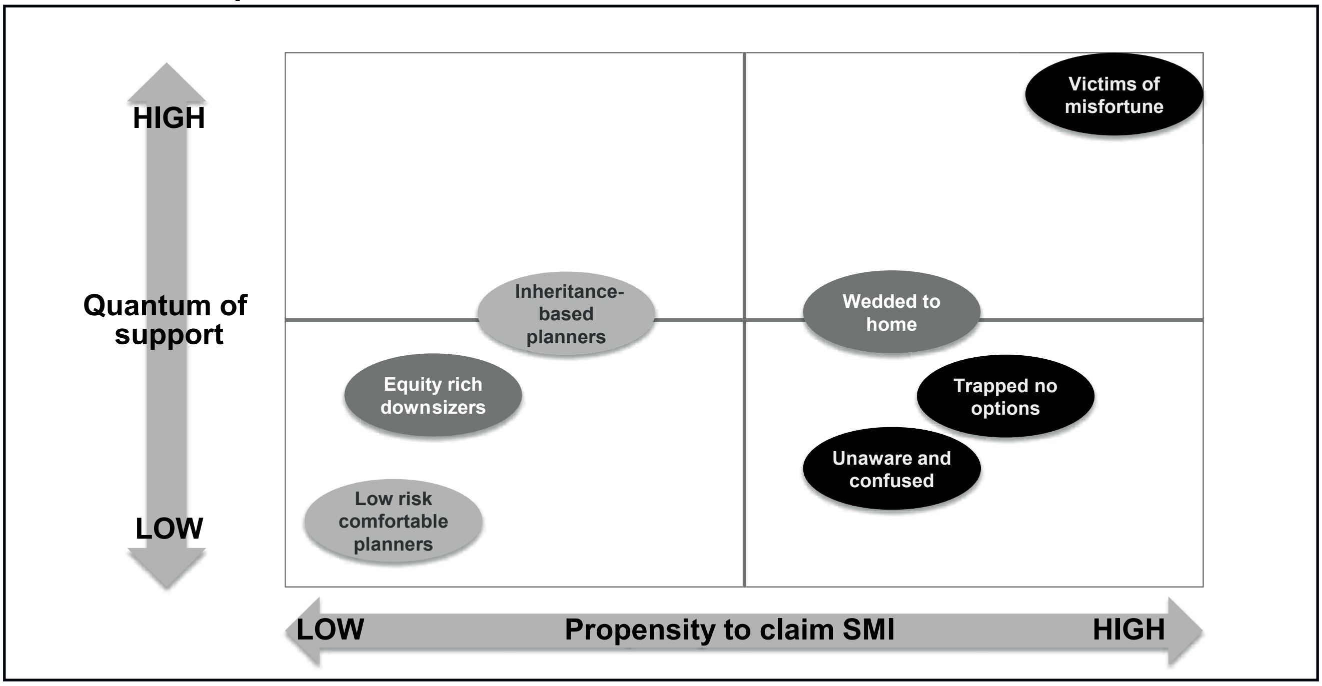


Figure 6.2 maps the various types against the two axes of propensity to claim SMI and the likely quantum of support required.

Figure 6.2 Claimant typology: Propensity to claim SMI and quantum of support required



7 Conclusions

For older people[19] taking on interest-only mortgages or borrowing over extended terms into retirement, mortgage choices rest on a deeply rooted cultural conception that home ownership is always a superior tenure to rental. This is as much about emotional and psychological benefits as it is about practical considerations such as the belief that rent will be more expensive than mortgage payments and an aversion to rent payments as 'dead money'. These perceptions are in turn underpinned by the deeply ingrained concept of 'the property ladder' and the conviction that house price inflation will deliver capital gains.

People on low incomes take on mortgages, including interest-only mortgages, with terms stretching into retirement, for a range of pragmatic reasons. Individuals try to balance aspirations for home ownership with the realities of limited resource. People want – and often need – to maximise the affordability of mortgage payments. They are also concerned to achieve as much flexibility as possible around the timing of repayment of capital, a particular consideration for those relying on inheritance or planning on downsizing. Finally, people want to maximise the benefit from long-run house price inflation while also expecting to have a longer working life in which to service mortgage debt.

There has also been a move in thinking about property wealth in retirement; rather than leaving property wealth for the next generation to inherit, some people now want to minimise housing outlay with the intention to use property wealth to enhance retirement lifestyles.

Around half of those with a mortgage now aged 50–64, covering 1.2 million households, are scheduled to repay their mortgage after the age of 65. Generally, people deciding to take mortgages into retirement recognise the trade-offs involved. In many cases it is a 'needs must' pragmatic decision. Borrowing into retirement does not of itself appear to be a major issue for most older mortgagors who would seem likely to extend their working lives to accommodate further years of debt service. Mortgage balances are in most cases low and mortgage payments appear significantly cheaper than rental payments for this age group.

One in five households aged 60 plus who have a mortgage (or who have mortgages), have an interest-only mortgage. For the better off, an interest-only mortgage has provided the opportunity to leverage incomes to build assets through house price inflation. These borrowers have not only built housing wealth more effectively than their counterparts on repayment mortgages, but have also tended to live in more expensive, and thus more desirable, properties. For those on low incomes, on the other hand, interest-only has often been the only 'affordable' route into home ownership and the only means to meet housing need at a manageable cost.

Although most people take on interest-only mortgages knowing the trade-offs involved, there is a minority of interest-only borrowers (being those on the lowest incomes and with no retirement provision other than State Pensions and thus most likely to claim Support for Mortgage Interest (SMI)) who may not understand the contract they have taken on. They may be unaware even of the need to repay capital or the risk they face of losing their home at the end of the mortgage term.

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[19] The CML data suggests that even in 2010 post the financial crisis, 85 per cent of mortgagors over 55 agree that owning property is a good way to make money, 79 per cent that owning property gives you more control over your life and 86 per cent that owning property makes you more financially secure.

All of that said, the qualitative research and secondary analysis suggest that interest-only mortgages coming to the end of their term are possibly less problematic than the headline numbers would suggest. This research suggests that most interest-only borrowers have resource in place (or anticipated as inheritance) or plans to muddle through to a solution and that these are not radically different to those of interest-only borrowers who have succeeded in paying off their capital in the past. Interest-only mortgages with no linked investment vehicles are, moreover, much more common among those mortgagors in the bottom 20 per cent of income distribution, being almost twice the level among the population of interest-only mortgage borrowers overall.

There is also a group whose planning for later life has been predicated on continued easy access to mortgage finance and whose plans to extend their mortgage term, refinance their borrowing, downsize and reduce their mortgage exposure, whose plans may not now be realised in a post-Mortgage Market Review (MMR) world.

A proportion of low-income, older interest-only borrowers recognise that they will simply have little option but to sell at the end of the mortgage term, and plan to do so, accepting, however reluctantly, that this is the trade-off they have made. It would seem likely that, unless a market solution can be found, their ranks will be swelled by reluctant sellers for whom the new, stricter affordability criteria operated by mortgage lenders will act as an absolute barrier to extending their mortgage term or raising new borrowing. Some older mortgagors, who prior to the MMR might have been able to remortgage to release funds, extend an interest-only mortgage, or take on new, reduced mortgage borrowing, will now no longer be able to do so due to the stricter affordability criteria. Some will be able to access equity release or lifetime mortgage products, while others will be reluctant or unable to do so.

The quality of the overall outcome, for both willing and enforced sellers, will depend largely on the degree of housing wealth individuals have built up over the course of their mortgage tenure, which will have considerable geographical variation. In many cases, however, the outcome will not be as envisaged by older borrowers who at the point they entered into their mortgage contract planned to downsize or remain in their property through an extension of their mortgage term, as this could now be out of reach.

There is some potential for awareness-raising both among those borrowers whose expectations on refinancing or extending the mortgage term have become unrealistic in the new mortgage landscape and among the group that do not understand the interest-only product they have taken on. Some of the former group may be in a position to ameliorate their position by forward planning for the new situation they will now find themselves in. The latter, however, are those least likely to have the resource to address the capital repayment problem once they are made aware of it.

The real issues and challenges for the future relate, on the one hand, to the perceived inadequacies and poor value of current market solutions and, on the other, the implications of the inflexibility of the constraints around lending to older borrowers which have followed from the MMR.[20]

[20] The FCA were clear in their review that they did not intend to prevent borrowing into retirement but rather to prevent older borrowers take on unsustainable debt.

It is clear that there is little or no awareness of SMI among low-income mortgagors and expectations of access to SMI are playing no role in mortgage decision making or planning for retirement. People claim SMI when circumstances leave no other choice, typically as a result of misfortune or when unable to service a mortgage in retirement, due primarily to ill health rather than any lack of willingness to work to service a mortgage. SMI claims in any case appear more likely to have been intermediated by third parties than initiated by SMI claimants who appear to have had little prior awareness of their entitlement to claim.

Those claiming SMI appear to have benefited from support in difficult circumstances. Were SMI not to be available, welfare claimants on qualifying benefits would seem likely to have lost their homes and in most cases may have been diverted to the rental sector. Outcomes would seem likely to have been both worse and more expensive, for both claimants and the state.

There will always be disruptive life events which will derail even the most carefully laid financial plans, whether while individuals are still of working age or in retirement. SMI will continue to represent much needed assistance for such home owners. Overall, it is clear that the availability of SMI is not distorting the market or mortgage decision making but is rather functioning as a cost-effective ‘*safety net*’ for those home owners who become unable to help themselves through no fault of their own. It would seem likely that loan-based SMI could perform the same function and deliver similar benefits, with this approach likely also to be viewed as fair and reasonable, by new claimants at least.

Appendix A Literature review

A.1 Overview on SMI

Support for Mortgage Interest (SMI) is the main state safety net provision for homeowners who cannot meet their mortgage payments. Under the current system, a contribution is made towards interest payments on their mortgage or loans they have taken out for certain repairs and improvements. SMI does not provide help for capital repayments or arrears, or endowment or insurance premiums.[21]

The safety net for homeowners has existed within the UK benefits system since 1948 when, under the National Assistance Act 1948, support was introduced for mortgagors who suffered a sudden or unexpected loss of income (Cowan *et al.* 2012). The rationale was to provide short-term help in order that beneficiaries would be able to avoid repossession of their homes while seeking to move back into work (DWP, 2015).

Since its introduction, the homeowners' safety net has evolved through a number of modifications and reforms.[22] Nonetheless, eligibility for SMI has long been determined on the basis of means-testing and that remains the case. Currently, eligibility depends on receipt of one of the qualifying income-related benefits:

- Pension Credit (PC) – an income top-up benefit for persons who have reached the qualifying age, which is the same age as women's State Pension age (SPa). A couple can apply so long as one member has reached the SPa.
- Income-based Employment and Support Allowance (ESA) – a means-tested benefit for working-age people who are unable to work due to illness or incapacity.
- Income-based Jobseeker's Allowance (JSA) – a means-tested unemployment benefit which is claimed by those who are looking for work.
- Income Support (IS) – paid to working-age persons who do not have to sign on as unemployed, mainly lone parents but also including persons with a disability who have been on the benefit since before the introduction of ESA.

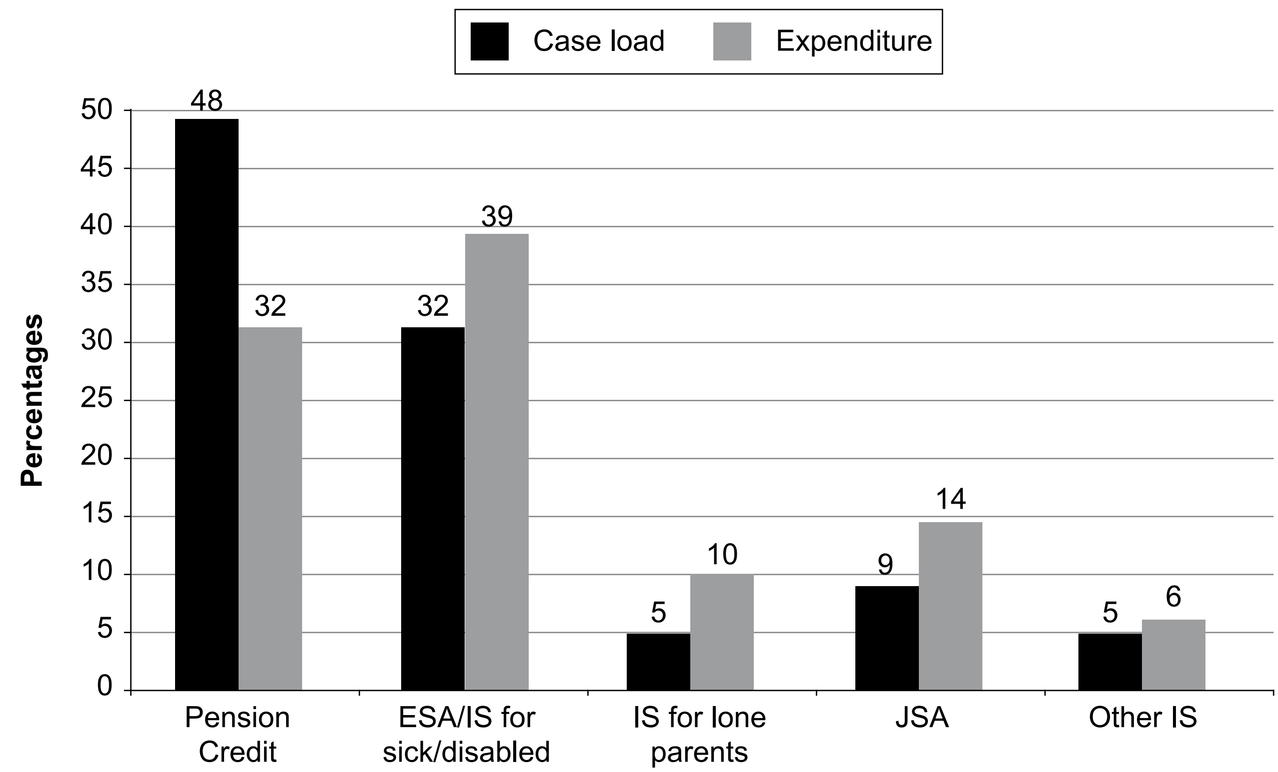
21 See DWP (2012) for an overview on the current rules and Kennedy (2013) for a more detailed discussion.

22 Annex A to the DWP (2012) consultation paper provides a brief history of support for mortgage interest. Kennedy (2013) also provides a brief history. Tunstall *et al.* (2013, p. 44) discuss developments from 1995 onwards and provide comment on the impacts of selected changes, drawing on the literature. The SMI role in the housing safety net is reviewed in Houston *et al.* 2014.

In addition, Universal Credit (UC) is now being rolled out and will, over time, replace the working-age benefits listed above. SMI will still be payable under UC, to those who do not have any work.[23]

In 2014/15, total expenditure on SMI amounted to £291 million on a caseload of 164,000.[24] PC claimants accounted for almost one in two (48 per cent) of the caseload total; reflecting their lower mortgage balances, their expenditure share was less at a little under one-third (32 per cent).[25]

Figure A.1 Composition of SMI expenditure and caseload, by qualifying benefit, 2014/15



Source: DWP.

Among those in receipt of ESA, SMI support is heavily concentrated in the Support Group, i.e., those whose illness or disability severely limits what they can do. In 2014/15, the Support Group accounted for 65 per cent of SMI expenditure on ESA claimants.

23 The restriction to those who do not work is different from the rules pertaining under the benefits that will be replaced by UC, which permit part-time work, up to 16 hours per week. Eligibility for PC will also change for new couples claims; so long as one member is under SPa, the couple will have to claim UC.

24 Source: DWP, Benefit expenditure and caseload tables 2015, 30 September 2015 update, available at https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2015

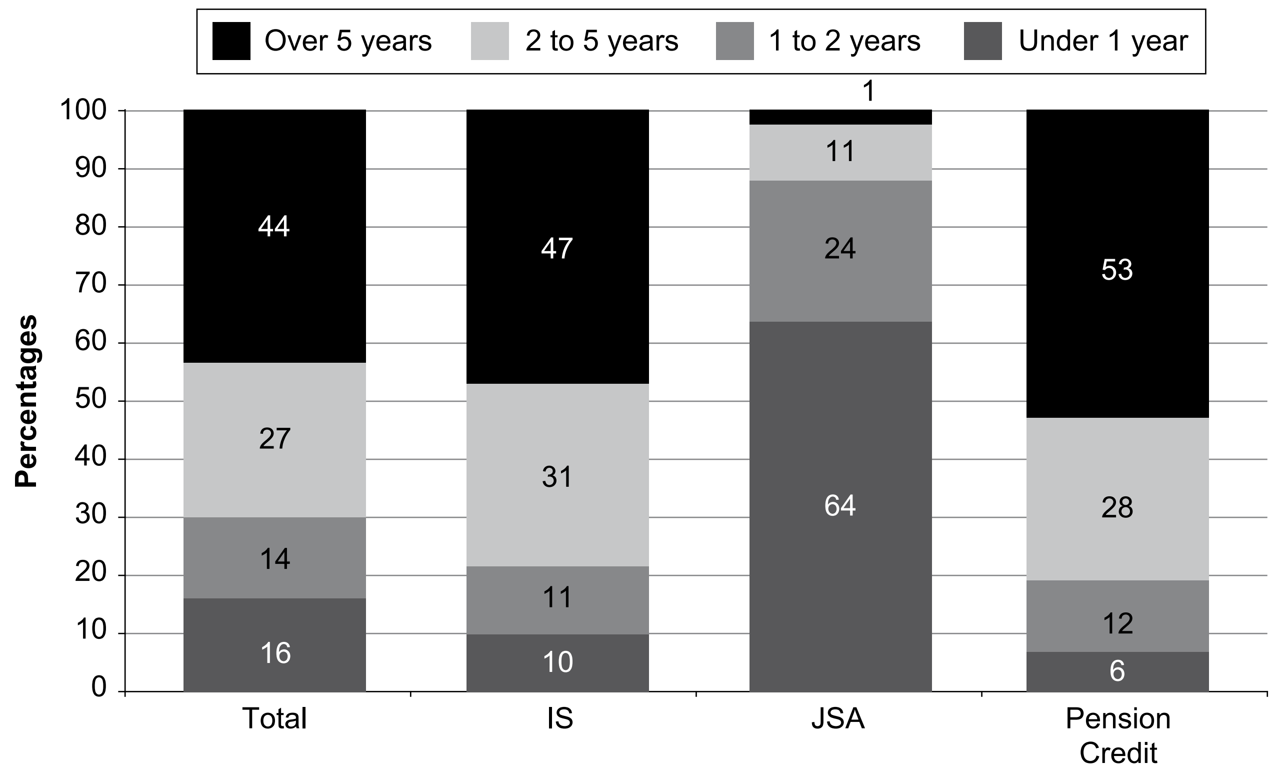
25 See the estimates for mortgage balances outstanding by age group in the accompanying secondary analysis of FRS data (slide 40).

Overall, there is a substantial cohort of SMI claimants for whom work is not considered an exit route, whether because of retirement or disability. For those claimants, the qualifying benefit (PC, IS or ESA) can provide more or less long-term support.

For PC claimants, and working-age claimants who are not expected to seek work, SMI enables them to remain in their homes, rather than serving as a short-term support while looking for work. On those benefits, the need can be more or less indefinite. That is reflected in the duration of SMI caseloads by type of benefit. As at 2011, over half of PC claimants had been on the benefit for over five years (Figure A.2). A similar proportion of claimants on IS (47 per cent) had spent five or more years in receipt of SMI. By contrast, almost nine in 10 claimants in receipt of JSA (88 per cent) had been on the benefit for less than two years.

The contrast in durations by type of benefit reflects the different routes by which people come to claim SMI, i.e. joblessness, disability, changes in family circumstances, retirement, etc. As SMI does not provide support for capital repayments, the contrasts by duration also pose the question of how long-term SMI recipients are able to sustain their homeownership.

Figure A.2 SMI caseload by duration and type of benefit, 2011



Source: DWP, 2011.

The routes into SMI have received very little attention in the literature. That topic is best addressed by considering the links between homeownership and poverty, or how homeowners enter low income and come to have problems paying their mortgage. Before considering those issues, it is useful to first consider the topic of taking mortgages into retirement.

A.2 Mortgages into retirement

According to the Council of Mortgage Lenders (CML), the proportion of new mortgages that extend into retirement increased from 25 per cent in 2006 to around 33 per cent by the first quarter of 2014 (CML, 2014). Allowing for the sharp drop in numbers of new mortgages over that period (from about 140,000 per quarter in 2007 to around 70,000 per quarter in 2013), it would appear that there is a growing tendency for mortgages to extend into retirement.

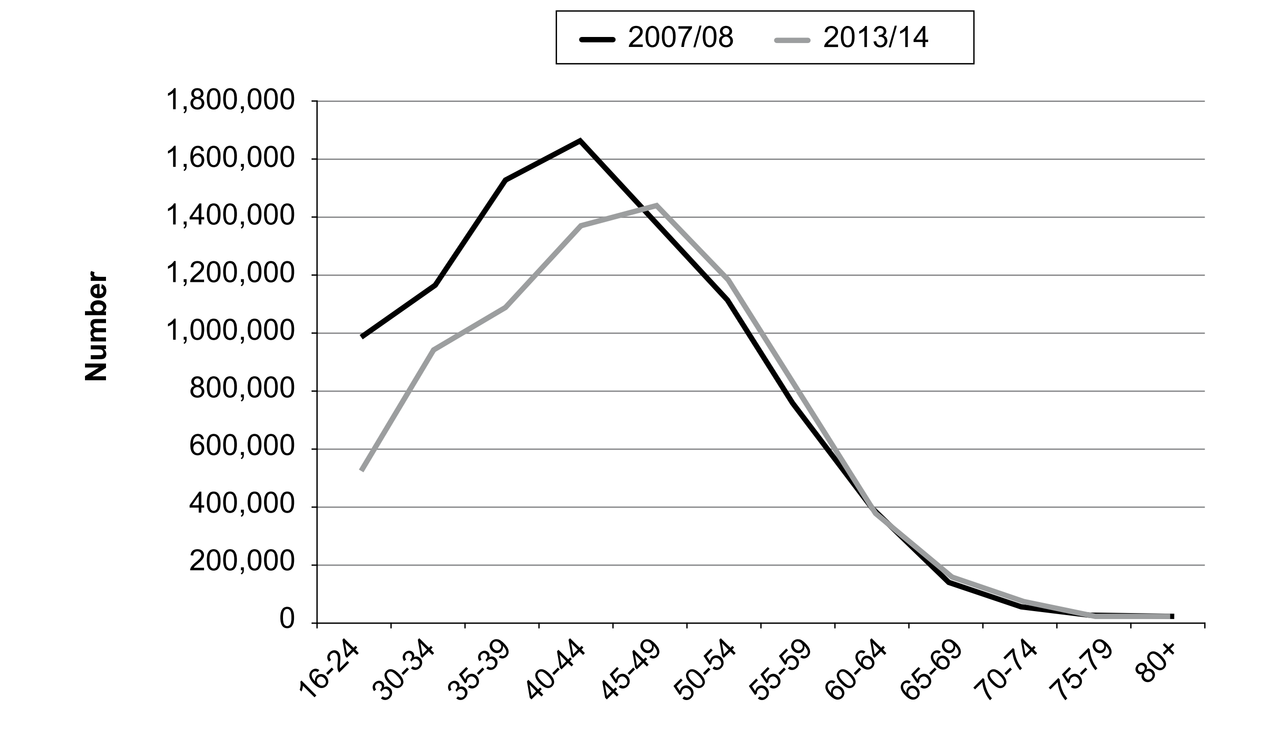
Commenting on that trend, the Financial Services Authority (FSA) remark that: '*This could indicate that lenders believe that borrowers have sufficient income in retirement or will remain in employment and be able to continue to meet their mortgage payments*.' (FSA, 2012, p. 104).

In the Policis CML survey, borrowers aged 50 and over with mortgages that already extend into retirement were asked to give their reasons for taking such a term, A little over one in two (51 per cent) said that they would not be in a position to repay the mortgage before retiring (see slide 20 in the accompanying secondary analysis of the CML data).

The CML survey respondents also gave a variety of other reasons related to affordability but also around financial planning.

Nonetheless, the inflows of new mortgages extending into retirement have yet to convert to any appreciable effect on the stock of mortgages held by those aged 65+. As can be seen from Figure A.3, over the period since 2007 the main change that has occurred in the age profile of those owning with a mortgage (an estimate of the stock of owner-occupier mortgages) has been the sharp drop in the numbers aged under-45. By contrast, the number of mortgagors in each of the age bands over 45 has remained relatively stable.

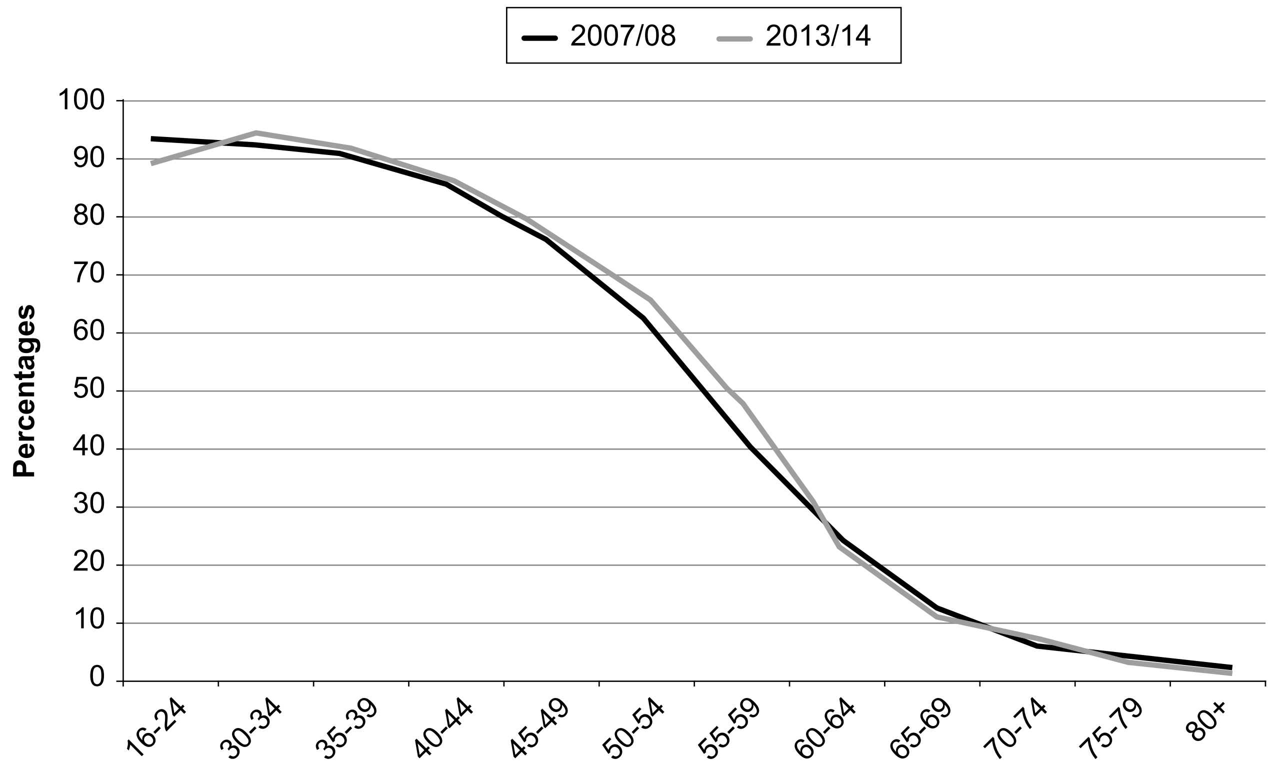
Figure A.3 Stock of mortgages, by age of head



Source: FRS.

Furthermore, within each age band, the proportion of homeowners that have a mortgage has remained relatively constant since 2007 (Figure A.4). The younger age groups predominantly own their accommodation with a mortgage while older age groups own their homes outright, having paid off the mortgage. Indeed, the mortgage rate curve in Figure 4 shows a pronounced flattening out between the ages 60 and 64, indicating the historical tendency to get the mortgage paid off before entering retirement.

Figure A.4 Owned with mortgage as per cent of owner occupiers, by age of head



Source: FRS.

The age profile of mortgage rates by age group is not unique to the UK. Similar patterns can be seen in the US (Chan *et al.* 2015) and the Netherlands (de Graaf and Rouwendal, 2012).

Within that context, the literature has little to say on why households take mortgages into retirement. Rather, the literature around home ownership and retirement is mainly framed around the standard life-cycle model, which posits that households accumulate wealth during their working years and dissave in retirement. That focus gives rise to topics such as why households do not draw down their housing equity in retirement. The factors mentioned in the literature include[26]:

- The bequest motive. The accompanying secondary analysis of CML data would suggest that attitudes to inheritance are changing as property wealth looms larger in financial planning for later life (Slide 19 in the accompanying report. See also Policis, 2010).
- Uncertainty regarding end of life, which creates an incentive to preserve some portion of wealth.

[26] See Rowlingson and MacKay (2000), de Graaf and Rouwendal (2012), Chiuri and Japelli (2010) and Venti and Wise (1990).

- The precautionary motive, albeit this would appear to apply more in the US where medical costs loom larger as an issue in later life.
- Housing is more difficult to liquefy. Equity release or lifetime mortgages products form a modest portion of the mortgage market in the UK (FSA, 2009, para 10.25).[27] Transaction costs associated with moving house, including ‘psychological’ costs of moving, such as ties to the local community. Banks *et al.* (2012) find that housing mobility among homeowners in the UK is much lower than in the US.[28]
- Trading down to a smaller home. The Banks *et al.* study found that when people do move they tend to downsize.

Putting aside the need for a move (which could be into care), it may not be rational for low-income homeowners to trade down. Whether such a move would provide the desired level of housing services would depend on the equity that could be realised from the current home. But lower-income homeowners tend to have lower levels of housing wealth (Banks *et al.* 2005; Tunstall *et al.* 2013). Indeed, a move may result in higher housing costs

Older households would seem to be averse to taking on mortgage debt past age 65. According to the CML, lending to persons of retirement age (assuming 65+) accounts for just one per cent of all new lending, including equity release lifetime mortgages (CML, 2015).

In a small-scale qualitative study of homeowners’ expectations around income in old age and views on using housing equity, Jones *et al.* (2010) reported that households emphasized the importance of being mortgage-free and disliked the idea of being in debt again, which would tend to limit demand in the equity release market. Conversely, based on a survey of 2,008 people aged 18+, Rowlingson and MacKay (2005) found that people in their 50s and 60s were ‘willing, if not keen to use up some of their equity in later life though they also wished to save some for bequests’. Similarly, the secondary analysis of CML data accompanying this review indicates that thinking about the role of property wealth in retirement has been shifting (Policis, 2010).

Bearing in mind the small scale of the market, the experiences of a sample of older people who took out an equity release product have been reported by Overton (2010) in a study conducted for Age UK. Overton achieved a sample of 533 equity release customers. The sample was drawn from a variety of sources, including four equity release providers and from databases provided by a number of voluntary bodies such as Age Concern England. The sample may not therefore be representative of the population of equity release customers. Nonetheless, the findings are of interest.

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27 See Williams (2010) for an overview on the market. Tunstall *et al.* (2013) Consider the role of equity release within the context of preventing poverty.

28 The five-year housing transition for homeowners aged 50+ in the UK was estimated at 12.5 per cent compared to 21.8 per cent in the US. Though, the transition rates were lower for those aged 60+ (circa 11 per cent) as compared with those aged 50-59 (14.4 per cent).

The median age of the survey respondents was 74. Around one in two (52 per cent) were married while the remainder were separated/divorced (11 per cent), widowed (28 per cent) or single (9 per cent). A majority took out a lifetime mortgage (62 per cent) with the remainder taking out a home reversion scheme (36 per cent). Compared to industry sources, therefore, the home reversion scheme products were overrepresented. Overton classified the respondents into three groups[29] according to their reasons for using an equity release plan, as follows:

- Making early bequests, or large one-off purchases. Typically better off than the other two groups. About one in four of the respondents (24 per cent) were classified into this first group.
- Increase financial security and enhance quality of life, by spending on a range of housing and non-housing items. This group tended to have lower levels of savings and pension income by comparison with the first group. They accounted for almost one in two survey respondents (46 per cent).
- Relieve financial difficulties. For this third group, equity release was a last resort and they were more likely to be in debt than the other two groups. Amounted to 30 per cent of the survey base.

Interestingly, 14 per cent of the respondents in Overton's survey mentioned PC as a source of income. Not unexpectedly, those respondents were most likely to feature in the third group listed above i.e. with financial difficulties (50 per cent of the PC claimants). However, as the release of capital would be expected to reduce their benefit entitlement, it would have been useful to know why those PC claimants participated in an equity release scheme. Overton can only speculate on that point, stating that those over 65 on a means-tested benefit are often only subject to a means test every five years and do not need to report changes in circumstances during that time. However, Overton is careful to note that the survey finding cannot be taken to mean that '*interaction with the benefits system no longer acts as a barrier to taking out equity release*' (p. 12).

A.3 Poverty risk and home ownership

The link between poverty and home ownership was highlighted in a paper prepared for the CML by Burrows and Wilcox (2000). In that report, the authors noted that, when income is measured before taking housing costs into account, homeowners comprise one in two of those who could be defined as poor (based on the households below average income measure). Subsequently, using the Poverty and Social Exclusion (PSE) Survey, Burrows undertook a detailed analysis of the sociodemographic correlates of poverty, both within the wider population and specifically among mortgagors and those owning their homes outright (Burrows, 2003, 2004).

29 The survey respondents were assigned to the three groups on the basis of a cluster analysis.

Not unexpectedly, Burrows found clear social class differences between poor and non-poor homeowners. He also found that, among mortgagor households, the odds of being in poverty were significantly higher for the younger age groups (25-44, depending on the poverty measure). Age was absent as a predictor of poverty among those owning their home outright, since such households are heavily concentrated in the older age groups.[30]

The research undertaken by Burrows is useful in highlighting the poverty risk among homeowners. A number of points can be made in that respect.

First, on a technical level, the use of a measure of income before taking housing costs into consideration will tend to overstate the proportion of homeowners in poverty.[31] In particular, those who own their homes outright incur relatively low housing cost, so their incomes are not much affected after adjusting for housing costs. The effect is shown in Table 1, where it can be seen that, in 2013/14, the owned outright tenure group accounted for 30 per cent of the low-income population (using the 60 per cent below median income threshold) on a before housing cost (BHC) basis but only half that level (15 per cent) on the after housing costs (AHC) measure. The low-income share of those buying with a mortgage is not hugely different AHC versus BHC. Rather, the main effect is to increase the social and private rented sector shares.

Table A.1 Low-income population by housing tenure: Composition (income threshold – 60 per cent below median), 2013/14

	Before Housing Costs (%)	After Housing Costs (%)
Owners	50	32
• Owned outright	30	15
• Buying with a mortgage	20	18
Social rented sector tenants	29	34
All rented privately	22	33
All	**100**	**100**

Source: DWP, 2015.

Furthermore, the poverty risk measure (the proportion of a given population with incomes below the poverty threshold) also varies according to the treatment of housing costs, both for the population as a whole and by tenure group. For the population as a whole, the poverty risk measure is lower BHC (15 per cent) than AHC (21 per cent) (Table 2). In particular, the poverty risk for households owning outright drops from 17 per cent BHC to 11 per cent AHC.

30 In fact, Burrows' poverty rate models for owned outright struggled to find statistically significant correlates, but that may reflect sample size limitations. The sample sizes for the owned outright poverty rate models ranged from 343 to 447, depending on the poverty measure used, but the statistical modelling that he employed performs best with large samples.

31 For a more detailed discussion of incomes before and after housing costs, see Appendix A in Belfield *et al.* (2015).

In general, the AHC measure is preferred when measuring poverty across different groups within the population (Brewer *et al.* 2009). Thus, in the secondary analysis of the Family Resources Survey (FRS) that accompanies this review, the AHC measure is used for analysis of households on low incomes.

Nonetheless, it is noteworthy that, even on the AHC measure, homeowners accounted for an estimated 32 per cent of the low-income population in 2013/14, with almost one in five (18 per cent) of those in a low-income household owning with a mortgage.

Table A.2 Low-income population by housing tenure: Risk of poverty (per cent with household income 60 per cent below median), 2013/14

	Before housing costs (%)	After housing costs (%)
Owners	12	11
• Owned outright	17	11
• Buying with a mortgage	8	10
Social rented sector tenants	26	43
All rented privately	17	37
All	**15**	**21**

Source: DWP, 2015.

That in turn poses a number of questions:

- Which comes first – the move into homeownership or having a low income?
- Do low-income homeowners tend to remain in poverty, as a protracted spell of low income might be expected to jeopardise their tenure?

The available evidence would suggest that homeownership tenure precedes moves into low income. Burrows (2004) contends that:

> *'… the growth of low-income home ownership must be accounted for by the changes in life circumstances that homeowner households encounter after they have entered the tenure. The critical changes of circumstances include the predictable, such as retirement, and the unpredictable, such as unemployment, loss of earnings, long-term sickness and relationship breakdown'.*

Burrows' conclusion is reinforced by the findings from Meadows and Rogger (2005) analysis of low-income homeowners in Britain. Meadows and Rogger found that '*almost all low-income homeowners owned their homes before they experienced a fall in income*'.

Research into mortgage borrowing and claiming Support for Mortgage Interest in retirement

Using data from the British Household Panel Study (BHPS),[32] Meadows and Rogger also examined movements into and out of low-income home ownership. According to the BHPS data, over a 12-year period, a quarter of all households experienced at least one spell of low-income homeownership. One in two of those households were in that position for only one year, i.e. their economic position recovered sufficiently to move them out of low-income status. A further 25 per cent of households experienced a spell of low-income home ownership lasting two years. Meadows and Rogger also sought to develop a statistical model for predicting key life changes (losing a job, becoming disabled, losing a partner, the birth of a child) that might be associated with moves into low-income home ownership. That did not prove feasible.[33] One reason for that, according to the authors, was that the majority of homeowners experiencing the life changes that could be observed on the BHPS did not subsequently slip into poverty.

While Meadows and Rogger were not able to statistically model the effects of life changes on moves into low income among homeowners, the impact of factors such as employment loss and relationship breakdown are evident from other analyses of shifts into and out of low income. For example, the Department for Work and Pensions (DWP) assessment of low-income dynamics based on the BHPS 1991 to 2008 found that falls in earnings of the head of household accounts for the largest share (42 per cent) of moves into low income (DWP, 2010, Table 11.1). Change in status to a single-parent household was associated with a relatively high probability of a move into low income (29 per cent of those affected), albeit the number of such events amounted to just five per cent of the total number of moves, due to the relatively lower frequency of such events in the population.

Similarly, moves out of low income were mainly associated with income events, both via the labour market (earnings, number of workers in the household) and through other means (e.g. income from benefits, pensions and/or investments).

The analysis by Jenkins (2011) further illustrates the range of experiences of income poverty over an extended period of time. Over the period from 1998 to 2005, Jenkins found that, on average, eight per cent of non-poor people enter poverty while 37 per cent of people in poverty moved out of poverty. Changes to employment and earnings were identified as the main routes into and out of poverty.

Nonetheless, Jenkins' analysis points to the persistence of poverty among a sub-set of the population; an estimated ten per cent of those entering poverty remain poor for at least eight years. Pensioners were more likely than working-age households to experience persistent low income. Partly, they lack the escape route provided by employment.

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32 A longitudinal study, i.e. a survey which follows the same sample of individuals over an extended number of years. The BHPS ran from 1991 until 2008, when it was subsumed into the Understanding Society survey (see https://www.iser.essex.ac.uk/bhps).

33 They used a logit regression approach, which did not yield statistically significant estimates for the hypothesised predictor variables.

In overall terms, pensioner poverty has been falling over the past number of years, from almost 30 per cent in the late-1990s to under 15 per cent by 2013/14 (Belfield *et al.* 2015, Figure 4.2). That reflects the faster growth of pensioners' income over the recent past, reflecting three factors (Belfield *et al.* 2015):

- Pensioners' incomes are less reliant on the labour market, and the earnings of workers rose relatively slowly pre-recession and have fallen since the recession.
- Recent discretionary cuts to benefits have been concentrated on working-age rather than pensioner benefits (and the basic State Pension has been protected by the so-called 'triple lock').
- There has been strong growth in income from occupational pensions across successive cohorts of retirees.

Within the pensioner population, low-income rates tend to be higher for single pensioners (18 per cent) than couples (12 per cent) and for women (19 per cent of single female pensioners) than for men (15 per cent of single male pensioners). The disparity between women and men is likely to reflect differences in the resources that they possess entering the retirement years. As Hills (2010) notes:

> *'Differences in employment and earnings during working life lead to women having lower pension rights than men. It can no longer be assumed that women's income in retirement will effectively be provided by their husbands. Some of the past labour market differences affecting the current generation of women pensioners have narrowed, but they, nevertheless, remain substantial for those who will form the next generation in retirement.' (p. 384).*

Hills also points to the importance of previous work history and membership of pension schemes as a factor that affects the level of resources that disabled people carry into retirement:

> *'Low employment rates and low hourly wages for disabled people also lead to lower membership of private pension schemes and lower rates of qualifying for state pensions. For some this will be compounded if another family member stops or reduces paid work to care for them, or if they care for another.'*

Thus, while pensioner incomes have been growing faster than working-age incomes in recent years, there are clearly sub-groups who are at risk of entering retirement with relatively limited accumulated resources.

In a study of changes occurring around State Pension age (SPa), Chanfreau *et al.* (2013)[34] found that low-income households most likely to reach SPa and **remain** in low income had the following attributes:

- Lack of private pension savings.
- No work before or after reaching SPa, or most recently working in routine or manual occupations.
- Long-term illness or disability.
- No qualifications.
- Being single and living in rented accommodation.

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34 The research was commissioned by AgeUK – see also Norton and West (2014) for Age UK's summary of the findings.

Households found most likely to **enter** low income after reaching SPa were characterised by:

- Lack of a private pension.
- Stopping work.
- Previously worked in an intermediate occupation.
- Becoming single, either through bereavement or separation.

Finally, **exits** from low income in the transition to SPa had the following features:

- With private pension savings.
- Not working before and after SPa.
- Single households.

The findings in relation to the attributes of households making exits from low income are perhaps surprising in relation to not working either before or after SPa. One possibility is that, for some households, reaching SPa can result in an increase in income from benefits, notably the State Retirement Pension, and possibly also topped up by PC. In the DWP analysis of events associated with movement out of low income, a rise in benefit income was associated with a 46 per cent probability of exit for those receiving an increase.

Chanfreau *et al.* did not distinguish between owner-occupiers and renters in analysing transitions around SPa. As the study focused on income levels, nor was mortgage debt included in the analysis.

Nonetheless, the Chanfreau *et al.* findings clearly highlight the importance of private savings as a resource affecting income prospects beyond SPa. Income prospects after reaching SPa are also affected by life events, such as bereavement, separation and illness/disability.

The same mix of factors is also apparent in a qualitative study of the relationship between pensioner poverty and material deprivation conducted by Kotecah *et al.*[35] (2013), who add the additional ingredient of financial planning. In their sample of 29 pensioners aged 65+, Kotecah *et al.* found that 'the routes into low income involved interplay between three key factors: low earnings during working life, the level of financial planning undertaken for retirement and the effect of key life events on these plans (divorces and deaths).' In the Kotecah *et al.* study, the financial planning route is effectively about pension provision.

Beyond retirement, routes out of low income are highly restricted. Traditionally, retirement is considered to represent a permanent state accompanied by a withdrawal from work, i.e. the decision whether to work at all rather than how many hours to work (Banks and Smith, 2006). The reversal of the retirement decision ('unretirement') does happen, as a fraction of the retired will return to work. However, that fraction is unlikely to include retired individuals seeking to make an exit from low income.

[35] Based on 29 in-depth interviews with pensioners aged 65+ who had taken part in the FRS 12 months previously.

Emmerson *et al.* (2014) project employment rates over the period to 2020/21 for men and women approaching and moving past SPa. Reflecting the continued increase in the SPa for women, the proportion of women aged 60-69 who are in employment is expected to rise. Employment rates for 70-79-year-olds do not show any discernible movement in Emmerson *et al.* projections in excess of their current low levels.

Drawing on the English Longitudinal Study of Ageing (ELSA),[36] Kanabar (2015) finds that unretirement is more typically associated with a 'lifestyle decision' than a response to a negative income shock:

> *'… unretirement is more likely among individuals with a higher level of educational attainment, who have a spouse in the labour market and are in better health'.*

A.4 Homeownership risks and mortgage arrears

Ford (2006) notes that 'risk is now an enduring feature of the owner-occupied market' and goes on to elucidate the risks in the following terms:

> *'The significant risks to home owners include unemployment, small business slowdown and failure, reduced income from work, relationship breakdown, household change, ill health, over-indebtedness and inadequate public and private safety nets'.*

Those risks can materialise in mortgage payment problems, leading to arrears and, for some, loss of the home through repossession. Ford considers lower-income borrowers are considered to be more exposed to the foregoing risks due to their greater risk of unemployment and lower income levels. However, the circumstances that are associated with the risk of arrears can arise both as a consequence of personal misfortune or can be transmitted through wider mechanisms, such as downturns in the economic cycle or structural shifts in employment patterns.

In a 2004 study, based on data from the (former) Survey of English Housing (SEH), Ford *et al.* classified the reasons given for mortgage arrears into three main categories (note that respondents could give multiple reasons, hence the proportions below add up to more than 100 per cent):

- Loss of income – 61 per cent of reasons given in 2002/03, including sickness/injury (22 per cent), reduction in self-employment income (ten per cent), loss of work via redundancy or unemployment (16 per cent) and reduced hours (11 per cent).
- Household changes – 30 per cent of reasons given, including separation from or death of the partner/spouse (21 per cent), departure of another mortgage contributor (six per cent) and pregnancy or birth of a child (three per cent).
- Increase in expenditure – 30 per cent of reasons given, including increase in mortgage payments (13 per cent) and increase in other payments (17 per cent).

[36] The ELSA is a longitudinal survey of ageing and quality of life among older people. The study commenced in 2002; seven waves have been completed to date, with the eighth under way (http://www.elsa-project.ac.uk/).

The SEH respondents also gave various ‘Other’ reasons, left unclassified by Ford *et al.* and cited by 13 per cent.

Drawing on a review of the UK mortgage default literature, Cairns and Pryce (2005a) provide a further classification of the drivers of arrears and possessions, as follows:

- **Trigger events**, largely following categories shown in Ford *et al.* and arising from changes in the mortgagor’s economic position (e.g. unemployment, reduced income) and personal circumstances, notably divorce/bereavement and illness.
- **Financial resources**, including savings and whether or not the mortgagor has Mortgage Payment Protection Insurance (MPPI). This might also be considered to reflect the household’s financial resilience in the face of an adverse trigger event or income shock.[37]
- **Financial commitments**, including interest rates (mirroring the role of the debt service ratio in aggregate or macro models of default and arrears[38]), dependents and other debts.

Cairns and Pryce also argue for the inclusion of housing equity as a driver of arrears and possessions, on the basis that a reduction in housing equity may reduce a household’s ability to use remortgaging to consolidate debts and/or to lower the monthly payment.

In subsequent analysis of the incidence of mortgage repayment difficulties and arrears, based on BHPS data for the period 1992 to 2004, Cairns and Pryce (2005b) found that households with savings were ‘much less likely’ to experience mortgage repayment problems. MPPI was found to have a ‘*marginal effect*’. They also found that ‘*married households tend to have the lowest incidence of repayment difficulties, whereas divorce and separation tend to increase mortgage repayment problems*’. Social class was used as a proxy for the stability of mortgagors’ economic position and was highly correlated with the incidence of arrears (lowest for professional/managerial and highest for unskilled), albeit most noticeably at points in the economic cycle when unemployment was higher, e.g., 1992 rather than 2004.

The Cairns and Pryce analysis of BHPS data was useful in highlighting the link between savings and the incidence of mortgage payment difficulties. However, the exercise also illustrated some of the difficulties in assessing mortgage payment problems. First, such problems tend to have a relatively low incidence within the population of mortgagors. In the BHPS data, arrears ranged from 4.3 per cent in 1992 to just 0.7 per cent in 2004. Even with a sample of 3,600 mortgagors, the number of individuals with arrears will be relatively low. Defaults are even less frequent and cannot be modelled with the existing UK micro datasets.[39]

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37 Wallace *et al.* (2014) discuss the concept of ‘financial resilience’ in the broader context of ‘asset-based welfare’.

38 The debt service ratio is the outstanding balance times the interest rate as a fraction of disposable income.

39 See also the discussion in Aron and Muellbauer (2010, p. 2).

Second, the process by which household mortgage debt becomes impaired evolves over a period of time, from the onset of one or more trigger events and subsequent use of available financial resources, which could include accessing SMI after some period of time. That is, there are stages in the process, but survey datasets tend to show the picture at a particular point in time. Even though the BHPS is a longitudinal study, the Cairns and Pryce analysis essentially treated the data as a series of panels of cross-sections for exploring linkages between the hypothesised drivers and the incidence of payment problems and arrears.

Nonetheless, subsequent studies, typically of a qualitative nature, have tended to reprise the linkages to mortgage arrears identified in Ford *et al.* (2004). For example, in a qualitative study of the experiences of 41 individuals who went through voluntary possession or selling because of financial difficulties, Ford *et al.* (2011, p. 8) noted that:

> *'The key reasons for arrears were reduced earnings from employment, failed self- employment and/or relationship breakdown. The largest group of borrowers experienced both unemployment and relationship breakdown. Relationship breakdown left many couples with their income intact, but decreased their commitment to paying for the shared home not least as additional accommodation had also to be funded [*i.e., an expenditure effect*]'.*

In their evaluation of the new arrangements for SMI introduced in January 2009, on foot of the most 2008/09 recession, Munro *et al.* (2010) studied the experiences of 28 working-age individuals (the new arrangements were primarily aimed at making SMI more responsive to payment problems arising from recession-induced spells of unemployment). The main routes through which claimants came to SMI included: unemployment/redundancy; illness/disability; or relationship breakdown.

The litany of reasons outlined by Ford *et al.* in 2004, and further elaborated by Cairns and Pryce, continues to be cited in analyses of individual homeowners' risks of payment difficulties and mortgage arrears. For example, according to Houston *et al.* (2014, page 11):

> *'Risk factors concerning the housing safety net not only stem from changes in employment and housing costs but also from changes in household composition. Family and partnership breakdown bear a high risk of debt and* [periods of] *homelessness'.*

Appendix B
Chart data tables

Table B.1 Trends in interest-only mortgages 2005–2014 by income quintile: Percentage of all households owning with mortgage

	Bottom 20% of households incomes	Third and fourth deciles	Fifth and sixth deciles	Seventh and eighth deciles	Top 20%
2003-04	6.5	4.2	2.5	1.9	4.0
2004-05	9.3	5.1	3.3	3.6	5.4
2005-06	11.8	6.2	4.4	4.4	5.8
2006-07	10.2	6.7	6.5	5.6	6.7
2007-08	15.3	9.0	5.3	6.7	7.3
2008-09	16.5	10.5	8.6	7.0	10.4
2009-10	14.8	10.6	9.1	8.4	9.3
2010-11	18.1	11.1	9.5	6.6	9.1
2011-12	16.4	13.7	9.4	6.8	8.8
2012-13	17.6	11.1	9.0	6.9	9.6

Source: FRS 2003/04 to 2013/14.

Table B.2 SMI Caseloads by pension age and working age

	Pension Credit	Below PC age
2004/05	96	106
2005/06	101	97
2006/07	100	91
2007/08	99	82
2008/09	98	78
2009/10	100	100
2010/11	98	107
2011/12	92	98
2012/13	82	91
2013/14	73	82
2014/15	64	75
2015/16	59	84
2016/17	56	88
2017/18	52	86

Source: DWP, Benefit expenditure and caseload tables 2015, 30 September 2015 update, available at: https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2015 SMI Demographics.

Table B.3 SMI mortgages: Profile

	Less than 50	50-59	60-69	70+
SMI recipients	24.0	17.0	30.8	41.3
Non-recipients on a qualifying benefit, with a mortgage	8.5	9.8	14.4	34.2
All others with a mortgage	8.5	8.1	17.7	32.1

Source: FRS pooled data 2009/10 to 2013/14.

Table B.4 Intended plans and realised plans for interest-only mortgagors

	Current interest-only mortgagors (%)	Home owners who repaid an interest-only mortgage (%)
Gradually reduce size of mortgage as trade up over time	3	5
Gift from parents/other family members	3	4
Move into the rental sector	4	
Convert to a lifetime mortgage	4	2
Sale of a second home or buy to let property	5	3
Sale of other assets	6	2
Downsizing to a smaller property	13	5
Inheritance	14	20
Remortgage and extend the mortgage term	15	
Proceeds of investment vehicle linked to the mortgage	15	33
Proceeds of another investment vehicle	23	17
Gradually reduce size of mortgage as have funds available	23	27
By selling the property	26	19

Base: 419 Current interest-only mortgagors. 183 Home owners who repaid an interest-only mortgage.
Base: 385 Home owners who had paid off their mortgages.
Source: CML research 2010.

Appendix C
Topic Guides

DWP

Support for Mortgage Interest claimants in retirement
Draft topic guides for structured depth interviews

Qualitative research to support research into mortgage interest support in retirement

Table C.1 Phase 1 research: Depth interviews. Topic guide – Core topic guide

Topic	Themes to explore in interview	Interview prompts	Rationale
Contextual information and role of home ownership in planning and aspirations	• Personal and family background • Income and assets • Housing aspirations • Role of housing in financial and life planning	Please tell me a little bit about yourself, your family, who you live with Would you please tell me about your household income and where it comes from? Do you have cash savings or any other assets such as investments? How important to you has it been to own your own home? Where does your home fit within your financial planning? What plans do you have in relation to later life? How does your home fit into your plans? (Probe throughout for underlying dynamics)	Elicit broad background information on income and assets and where home ownership sits within life plans and plans for later life and build rapport.
Mortgage and borrowing history	• Property and mortgage history • Current property value and value of housing equity • Current mortgage details and values • Manageability of mortgage payments • Mortgage term • Plans for retirement/working in later life and role of mortgage within them	How long ago did you buy your property? Was it your first property? Tell me about your property and mortgage history over the years? What do you think your current home is worth? How much is the outstanding mortgage on your property? What kind of mortgage is it? Have you always had the same type of mortgage or have you had different types of mortgage in the past? How much does the mortgage currently cost you each month? How easy/difficult do you find that to manage? Have you considered what your mortgage payments will be if interest rates rise? How easy/difficult will it be for you to cope with higher mortgage payments? When does your mortgage term end? How old will you/your partner be then? How long do you/your partner expect to work? How does having a mortgage that extends into retirement affect your plans for working and retirement in later life	This section will provide the context for later questioning on drivers of mortgage choices and their expectations of the future. It will also feed into thinking around how the population of interest will segment and those groups which are more or less vulnerable and more or less likely to represent a relatively heavy burden for SMI in future.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Dynamics of historic mortgage choices and understanding of mortgage choices/ consequences of those choices	• Reasons for product choices • Thinking and practice on repayment vehicles • Thinking on choice of mortgage term • Thinking on mortgage extended into retirement • Understanding of interest-only (IO) concept	Thinking back now to when you took out your mortgage, why did you choose the mortgage that you did? (Probe for specific reasons made choice of repayment, endowment, interest-only mortgage) (See also separate section for affordability driven choice of IO mortgages) How did you arrange your mortgage? (probe for online, broker, tied adviser etc.) How far were you actively involved in the choice of mortgage or did you tend just to rely on the broker/mortgage advisor? Did you set up a repayment vehicle such as an investment fund or endowment fund when you set up the mortgage? Have you been able to keep that up? (see also separate section for lapsed repayment vehicles) How much do you think your repayment fund is worth now? How far is it keeping pace with your expectations of what it would be worth? Are you confident that it will be enough to pay off your mortgage? Thinking back now to when you were deciding how long your mortgage term would be, what was your thinking about setting the mortgage term to end when it does? Did you consider that the term could be after your or your partner's retirement? What was your thinking on going on borrowing into retirement? How confident are you that you will be able to pay the mortgage to the end of the term? How do you plan to do so? Thinking forward now to when your mortgage comes to an end, what is your understanding of what happens then? Will there still be capital to repay at the end of the term or will it all have been paid off? How was the position at the end of the term explained to you at the time? What are your plans for paying off the mortgage at the end of the term? (probe for investment vehicle, savings, sale of other assets, inheritance, sale of property etc and then probe for how realistic these are) Did tax considerations have any role to play in either choosing IO mortgage or extending mortgage terms into retirement?	This section is intended to uncover the dynamics of historic mortgage choices and how this will feed into demand for SMI. It also seeks to understand how far people understand the implications of the choices they have made historically and how current behaviour and thinking about paying mortgages into retirement may translate into future needs and outcomes. This will help determine: • How far different mortgage choices and potential claimant types will represent challenges for SMI in the future • The nature of the challenges which may arise • Which groups are more or less vulnerable • What messages might support a change in behaviours

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Continued		If so, in what way? (See separate section for those without plans/means to pay off IO mortgage) How confident are you of being able to pay off the mortgage? Is it something that you think about/worry about or not really? (probe for reasons why/why not)	
Expectations of how will handle retirement and role of mortgage within retirement planning?	• Expectations of income and how sourced in retirement • Role of mortgage borrowing within retirement planning • Thinking on how will handle/fund debt service and capital repayment • Role of housing equity in retirement planning • Expectations on moving, downsizing, equity release etc	How far have you/did you actively plan for retirement? (See separate sections for pension credit and for working-age SMI claimants) How much income do you expect to have in retirement and where do you expect it to come from? (probe for State Pension only, occupational/private pensions, other income sources) Do you expect to have any other sources of capital to cushion your retirement? (probe for whether anticipate relying on/realising some housing equity) If so, where do you expect this to come from? How comfortable/worried are you about the adequacy of your income/assets in retirement? Are you confident that you will be able to handle the mortgage payments until the end of the term? How far have you considered the likely impact of increases in interest rates? What difference do you expect rate rises to make and how will they impact affordability of mortgage payments in retirement? Do you plan to move/downsize/stay put in retirement? What are the reasons for your thinking on that? (probe for how realistic these are) Would you plan to have another mortgage if you were to move house/downsize? How easy/difficult do you think it would be to get a new (typically smaller) mortgage if you were to move to another property? Would you consider renting if you could not get another mortgage? (probe for why/why not and expectations on rental pricing relative to mortgage payments) (See also section for those not able to fully meet/meet the requirement for capital repayment of interest-only mortgages)	This section aims to understand the retirement planning of potential SMI claimants and where home ownership, mortgage borrowing and housing wealth sits within this. Given the vanishing availability of mortgage lending to older borrowers, it also seeks to explore what recent market developments may imply in terms of fit with potential claimants plans and what this might mean for the future of demand for SMI.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Understanding of benefits available in retirement and support for mortgage payments?	• Understanding of state benefits available to those of retirement age • Understanding of support available for mortgage payments into retirement • Understanding of limitations of support available • Expectations of lender requirements/ support • Expectations of state support for own mortgage payments in retirement • Whether and how any knowledge and expectations of SMI has influenced mortgage strategy	What state benefits are available to those in retirement? What expectations of state support do they have in their own case? (probe for whether have investigated entitlement and value) Is there state support available for mortgage payments? If think there is, how does the system work? (probe for what they think the state will cover – whole payment, interest-only, interest at what level) What conditions do you have to meet to get your mortgage interest paid? How do lenders react if someone isn't able to pay their mortgage, only able to pay interest element in retirement? (probe for sources of knowledge/perceptions in both cases) Are you personally expecting that you will need to look for state support to pay your mortgage in retirement? Do you expect that the state will pay all your mortgage payment or just the interest-only? How far did you consider the potential for state support for mortgage payments in retirement when you decided to borrow into retirement? How far did you consider the potential for state support for mortgage payments in retirement when you decided to take out an interest-only/repayment mortgage? How far did you consider the potential for state support for mortgage payments when you have been thinking about the timing of retirement? Would it have made any difference to your decision around the mortgage you took on if you had: • Known/not known (as appropriate) that SMI was available • Known/not known (as appropriate) that SMI would only cover mortgage interest payments	This section aims to explore awareness of SMI and understanding of the nature and availability of mortgage support into retirement. It seeks also to understand how, if at all, awareness of SMI and mortgage support into retirement has influenced/ is influencing mortgage borrowing and retirement decisions.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Impact of SMI not being available	• Options if SMI not available • Outcomes of SMI being withdrawn period • Awareness and expectations of market solutions • Appetite for market solutions	If SMI were not available/withdrawn what would see as options for handling mortgage payments in retirement? How well would be able to cope without SMI and what would see as likely outcomes? What adaptations would need to make to budgets/lifestyle/future plans? How far actually manageable in context of own personal finances? How would feel if SMI were to be changed into a loan? What difference would it make to their behaviour in future/any decisions they have made in past? If some spontaneous awareness, probe for how has changed their thinking, if at all Are they aware of any market options that could be available? (spontaneous and then probe for equity release, lifetime mortgages, then explain lifetime mortgage proposition if unaware) How attractive lifetime mortgage concept? What see as advantages/disadvantages? How likely to take up (on assumption that SMI not available and/or unable to repay capital)? If lifetime-style mortgages not available to them as individuals, what then would be options How see future retirement planning evolving in absence of SMI?	This section seeks to understand the possible outcomes for those potentially planning on/ relying on SMI or some form of mortgage support were this benefit to be withdrawn or curtailed. It seeks also to understand awareness of current market solutions, particularly equity release and lifetime mortgages and how far current market propositions are attractive to consumers and might act as an alternative to SMI for potential claimants.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Additional material for those with IO mortgages and stretched affordability **Including self-certified and self-employed**	• Choice of IO and thinking around it, dynamics of stretched affordability	When took out IO mortgage what were financial and personal circumstances at that time? What was thinking about mortgage/borrowing/home ownership at time took out IO mortgage (probe for whether sought to borrow largest possible amount/aiming to leverage income to greatest extent possible, maximise capital gains, unable to afford to live in area wanted otherwise, etc.) How important to them to keep outgoings low and why? Was thinking that IO temporary or permanent measure? If changed from repayment to interest-only what was thinking behind that? Whether saw as temporary or permanent shift? How far was mortgage term extended into retirement an active choice or was only way to make payments affordable? What was thinking at time took out IO mortgage on how would deal with eventual capital repayment? Have you evolved a strategy for repaying capital – and if so what? How has payment history evolved and how affordable have mortgage payments been? How well could you cope with a) an interest rate rise? b) an enforced transition to a repayment mortgage? How easy do you feel it would be for you to take out another mortgage? Where aware more difficult to get another mortgage and that IO mortgage now much less likely to be available, how does new barriers to taking on mortgage/IO mortgage impact your thinking on servicing mortgage debt into retirement, planning for capital eventual repayment? For those not aware: if you were not able to get new mortgage in future or to get another IO mortgage, how would that affect your plans for the future?	This section and the depth interviews with IO borrowers with stretched affordability seeks to explore the potential challenges for DWP of a group likely (in contrast to most existing claimants) to have high LTVs. They will also be those most likely to struggle as interest rates rise. This is also the group least likely to be able to take on alternative mortgages in the current market climate – the most likely ‘mortgage prisoners’ while also being those least likely to be in a position to repay the capital at the end of the term. The insights arising will assist DWP in thinking through effective policy solutions for this potentially highly challenging – and likely expensive – client group.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Additional material for those without means/plans for capital repayment	• Expectations on reaching end of term when unable to repay capital	How much have you thought about/planned for what will happen at the end of the mortgage term? Why have you not been able to put in place a plan for repaying the capital at the end of the term? What are your expectations of what will happen when reach end of mortgage term and unable to repay? What do you see as the likely options at that time? (spontaneously then probe remortgage/extend term/sell and downsize – with or without remortgage/sell and move into rental sector/lifetime mortgage etc)	This section aims to provide greater depth on the likely challenges arising for those unable to repay their capital at the end of the term and the potential options and outcomes for this claimant type.
Additional material for those with lapsed repayment vehicles	• Dynamics behind lapsed repayment vehicles	What were your personal the circumstances when you stopped paying into the repayment fund? What were the reasons for your stopping making payments? Did you see as a permanent or temporary move? Did you have an alternative plan for repayment? If so, what? What do you see as the likely consequences of having let the repayment fund lapse?	This section aims to understand the dynamics around lapsed repayment vehicles and the potential thinking and forward planning of those who are in this position.
Additional material for Pension Credit claimants claiming SMI	• Role of Pension Credits and SMI in retirement planning	Before you reached retirement age had you considered pension credits and SMI in your retirement planning? How important was the prospect of pension credits and SMI in your decision to borrow into retirement? What would you have done differently if knew SMI not available? How important has SMI been in your ability to stay in your own home? Would you have had other options? What impact has the limitations around SMI had on your ability to service your mortgage?	This section aims to understand the thinking that pension credit claimants now claiming SMI brought to their retirement planning and how far the availability of SMI influenced their mortgage and retirement planning choices.

Continued

Table C.1 Continued

Topic	Themes to explore in interview	Interview prompts	Rationale
Additional material for working-age claimants of SMI	• Role of SMI in attitudes to moving into work • Role of SMI in retirement planning	Benefits being claimed How long have you been on benefits this time? What were your circumstances when you started to claim benefits? Were you previously aware of SMI? What difference has SMI made to you being able to pay your mortgage and stay in your home? What impact has the limitations around SMI had on your ability to pay your mortgage and stay in your home? (probe for how those with repayment mortgage impacted) How does the fact that you are getting SMI influence your thinking on moving into work? Do you tend to think of SMI as a temporary benefit or one that you are likely to be claiming for the long-term? What difference has this period of being on benefits made to your thinking about retirement? What difference has the ability to claim SMI made to your thinking about retirement? What income do you expect to have in your retirement? How do you expect to service your mortgage into retirement? Do you expect to be claiming SMI into retirement?	This section aims to understand how the availability of SMI for working-age claimants has influenced thinking and behaviour on re-entry to the labour force and mortgage borrowing into retirement It also aims to understand how far working-age recipients of SMI see the benefit as a temporary life-line to keep them in their home or a longer-term benefit to support and maintain home ownership over the long-term.

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