National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 1030
SESSION 2010–2012

25 MAY 2011

Department for Communities and Local Government

The Mortgage Rescue Scheme

Summary

1 The number of repossessions in the UK (properties taken into possession by lenders following mortgage default) increased 54 per cent from 25,900 in 2007, to 40,000 in 2008. In response to concerns over further increases in repossessions and the declining economic situation, the Department for Communities and Local Government (the Department) devised, during 2008, a Mortgage Rescue Scheme (the Scheme) aimed at protecting the most vulnerable households from the negative impacts of repossession and homelessness. The Scheme is part of wider set of repossession-prevention initiatives, coordinated by the Department, and introduced across government since 2008. This report considers the Department's design, appraisal, implementation and management of the Scheme. It does not evaluate the wider effort to prevent repossessions more generally.

2 The Scheme is targeted at households that, in the event of repossession, would be accepted as homeless and whose local authority would therefore have a duty to secure accommodation for them. Households in priority need include families with dependent children and people who are vulnerable because of old age, or another reason such as illness. Participation in the Scheme depends on the household being able to demonstrate that they have exhausted all other options and are at imminent risk of repossession.

3 Under the Scheme, a local authority assesses the household and refers them for independent money advice. Then, if the household is eligible and makes a successful application, a housing association (an independent, not-for-profit body providing housing to those in need) either:

- makes an equity loan to the household (the **'shared equity'** option); or
- purchases the home at near-market rate, with the former owner remaining in the house on an initial three-year shorthold tenancy at up to 80 per cent of market rent (the **'mortgage-to-rent'** option).

4 The shared equity option requires that households have between 25 and 40 per cent equity in their home. No such requirements exist for mortgage-to-rent. Following completion, the Department reimburses housing associations for part of the cost of the rescue through a grant.

5 The Department launched the two-year Scheme in January 2009 with a budget of £205 million from the National Affordable Homes Programme, administered by the Homes and Communities Agency (the Agency). In April 2009 it added a further £80 million. In October 2010 the Department was allocated a further £221 million to continue the Scheme until spring 2013.

Key findings

On Scheme costs and impact

6 **The Scheme delivered 2,600 completed rescues between January 2009 and March 2011, less than half of those expected when the Scheme was launched.** At its launch in January 2009, the Department expected the Scheme to help up to 6,000 households over two years. After six months, only 18 households had accepted a formal Scheme offer, but numbers subsequently picked up.

7 **The Department has spent on average £93,000 for each rescue completed – it expected to spend £34,000.** The main reason for the higher-than-expected average cost is that most completed rescues have been the more expensive mortgage-to-rent type, with only a minority being shared equity. The Department had expected the opposite (**Figure 1**). The cost of the mortgage-to-rent rescues themselves is closer to plan, but rose from September 2009, when the Department sought to increase the availability of the Scheme by increasing the subsidy it provided to housing associations. On average this type of rescue has cost £93,000 (19 per cent more than the £78,000 expected). Since this change was reversed in July 2010, the cost to the Department of each mortgage-to-rent rescue has averaged £81,000 (4 per cent more than expected).

Figure 1
Summary of planned and actual Scheme costs and performance

		Planning Assumption	Actual
Number of rescues		6,000	2,600
Percentage of rescues of each type	Shared equity	60%	1.5%
	Shared ownership[1]	25%	–
	Mortgage-to-rent	15%	98.5%
Average cost to the Department per rescue[2]	Shared equity	£12,000	£57,000
	Shared ownership	£46,000	–
	Mortgage-to-rent	£78,000	£93,000
	Overall	£34,000	£93,000

NOTES
1 ‘Shared ownership’ was dropped from the Scheme in November 2008 because delivery partners thought it would be too complicated. The Department’s working assumption was that these households would take the shared equity route instead.
2 Cost information is taken from Homes and Communities Agency data. The £34,000 overall average is the budget of £205 million divided by the planned 6,000 completed rescues. The weighted average (taking account of the assumed balance of rescue types and corresponding planned unit costs) is £30,400, indicating that the Department allowed around 10 per cent headroom in budgeting.

Source: National Audit Office analysis of data from Department for Communities and Local Government and the Homes and Communities Agency

8 **The Scheme has had less direct impact on maintaining owner occupation than the Department expected.** Because of the low number of shared equity cases, almost all the households ‘rescued’ by the Scheme have remained in their homes as tenants of the housing associations purchasing their property, rather than as owners.

9 **The Scheme is likely to have helped prevent further repossessions and homelessness by referring households to sources of advice and support, but the Department cannot quantify this impact.** The number of households accepted as homeless, following mortgage arrears, fell from 2,340 in 2008, to 1,380 in 2009 and 1,050 in 2010 – an overall fall of 55 per cent. The Department believes that, in the absence of the Scheme, more households would have been made homeless in this way. It is reasonable to conclude that the Scheme has had an impact, but the Department does not have sufficient information to quantify the Scheme’s overall contribution.

- **Based on Scheme monitoring data, some 15,600 households have approached their local authority and been assessed as eligible since its launch.** These households should have received advice from the local authority, or been referred to their lender or money advice agencies, even if they did not go on to apply to the Scheme or complete the rescue process. Some of these households are likely to have avoided repossession as a result. The Department did not, however, take account of this type of wider impact in its initial estimates of Scheme costs and benefits, nor did it set quantified objectives for this impact, or collect detailed data on outcomes for households that only received advice.
- **Local authorities reported that they helped 3,600 households stay in their homes through interventions to address mortgage arrears in the 2009-10 financial year.** However, this number reflects not only the impact of the Scheme but also wider local authority homelessness prevention activity.

On the Department’s management of the Scheme

10 **The Department misjudged demand for the Scheme.** The Department assumed that most households would take the shared equity option based on: experience from earlier schemes in the 1990s; analysis of data on repossession risks; and stakeholder views. In reality, however, there have been hardly any shared equity cases (Figure 1). There may be several reasons for this. Greater lender forbearance, partly a result of government interventions introduced alongside the Scheme in late 2008 and 2009, may mean that households with more equity have been able to make alternative arrangements without recourse to the Scheme. Also, the eligibility criteria for shared equity are narrow, which limits the number of households that can qualify. The Department’s own evaluation suggested that, even when eligible, some households had turned down the shared equity option because they no longer wanted the responsibility of homeownership. The Department could, however, have estimated demand more accurately if it had made better use of information at the outset:

- The Department did not have detailed, up-to-date information on its target group to inform its assumptions, particularly around whether they would have sufficient equity in their homes to make shared equity a realistic proposition. It instead used a somewhat broader dataset covering the general characteristics of households at risk of repossession.
- The Department did not draw sufficiently on data from a similar scheme in Scotland, which has been operational since 2003. Evaluation of this scheme, ongoing in early 2008 and published in early 2009, showed that, in reality, only a minority of households would have had sufficient equity to use the shared equity option had it been offered.

11 The Department's appraisal of the Scheme's business case was weak. The Department:

- Did not quantify the financial implications of different patterns of demand for the mortgage-to-rent and shared equity options, in either its internal business case or its Impact Assessment. The Impact Assessment identified the possibility that the actual mix of cases could differ considerably from the assumptions made, but contained very little sensitivity or scenario analysis. For example, under a scenario in which nearly all rescues were mortgage-to-rent, the Department would have only been able to plan for 2,600 cases within the initial £205 million budget, based on its assumed cost of £78,000 per mortgage-to-rent rescue.
- Overstated the Scheme's potential benefits, relative to its costs. The Department's Impact Assessment estimated costs to the taxpayer, but included benefits to both the taxpayer and housing associations. To ensure a like-for-like comparison it would have been appropriate to also include the costs to housing associations (for example, the cost of borrowing to fund their contribution to the Scheme).
- Made fixed assumptions in its cost-benefit model that were not subjected to sufficient sensitivity or scenario analysis, including assumptions about housing benefit savings and whether housing associations would dispose of properties in the future (and accrue benefits or costs from changes in property values). Scope for this sort of analysis was reduced by the way the Department's model was put together, which did not make all the workings or assumptions clear.
- Did not use its consultation with housing associations prior to launch to validate its assumptions around future sales of houses acquired through the scheme.
- Did not submit its business case for external assessment using, for example, the Office of Government Commerce's model of project review, which could have challenged the Department's key assumptions more rigorously.

12 **The Department decided, after launch, to increase the Scheme budget by 40 per cent.** In May 2009, the Department increased the Scheme budget from £205 to £285 million. This reflected higher demand for mortgage-to-rent than was anticipated in its business case. At the same time, the Department extended Scheme eligibility to include households in negative equity. Borrowing up to 120 per cent of property value was allowed, though the Department's contribution remained linked to 97 per cent of value. Forty-five per cent of rescues have involved negative equity. Later, in September 2009, the Department increased the grant paid to housing associations from 55 per cent to 65 per cent of the purchase price to encourage more housing associations to take part in the Scheme.

13 **The Department and the Agency invested considerable effort to ensure national coverage and increased take-up.** Take-up of the Scheme was slow at first. The Department, in conjunction with the Prime Minister's Delivery Unit, considered the implementation of the Scheme in April 2009, before beginning work with local authorities to widen Scheme coverage. To increase the number of housing associations offering the Scheme, the Agency sponsored the publication of a toolkit and promoted 'syndication' arrangements with lead housing associations. The Department established a fast-track team to process referrals directly from lenders, but withdrew this service in September 2010.

14 **The Department did not take action to improve value for money early enough.** The Department recognised in May 2009 that because of the higher than expected take-up of mortgage-to-rent, average costs were much higher than anticipated. The Department did not, however, take action to control or reduce the costs of mortgage-to-rent cases until June 2010. By this time the Department estimated that, potentially, cases in the pipeline could use up the full £285 million available. The Department faced the possibility of having to close the Scheme early or risk overspending the budget. Following a review by the incoming Government, the Department chose to keep the Scheme open and reduce costs by:

- reducing its grant contribution to housing associations from 65 to 55 per cent of the purchase cost;
- capping the value of repair costs to which it would contribute at £20,000; and
- imposing stricter enforcement of regional limits on the value of homes which could be supported.

15 **Evaluation findings suggested the long term costs of each rescue outweigh the measurable benefits.** The Department followed good practice in commissioning an external evaluation, which attempted to model the longer term costs and benefits accruing to the Government and housing associations. The evaluation showed that an assessment of the Scheme's long-term value depends substantially on how costs and benefits are measured. Using a cash-based financial appraisal of costs and benefits to the public sector and housing associations, the evaluators estimated that each rescue carried a net present cost (i.e. a cost after accounting for measurable benefits) of £45,000 over 30 years. The evaluators also presented an alternative 'economic' assessment of costs and benefits which indicated a net present cost of £5,500 per case.

The evaluators identified wider personal and social impacts from avoiding repossession and from money advice received through the Scheme. However, they were unable to quantify the extent of these impacts because of the lack of data on wider outcomes, and on outcomes for households that approach their local authority for advice but do not go on to complete the full rescue process. The evaluators also acknowledge significant uncertainty around the long-term sustainability of outcomes given the interim nature of their work.

16 The Department is now focused on reducing costs further, and managing demand for the Scheme downwards. The Department reduced the amount paid for cases referred to housing associations after 1 March 2011 from 97 to 90 per cent of market value, thereby requiring a greater contribution from households (or, where households have little or no equity, the lender). This partly recognises the potential financial advantage that lenders may receive through participation in the Scheme, compared with the alternative of forced sale following repossession. The Department has also reduced its contribution to housing associations' purchase and repair costs to 47 per cent. Had these new rates been in place from the start, the Scheme would have cost £72 million less in the period to the end of March 2011. The Department considers, however, that it would not have been possible to secure housing association or other stakeholder engagement with the Scheme at this grant level from the outset.

17 The Department acknowledges the risk that its proposed changes to manage costs could reverse its earlier efforts to secure national coverage. A reduction in the grant rate increases the risk of patchy delivery if housing associations or lenders elect not to participate in the Scheme. This is a risk the Department accepts.

18 The Department is now relying on housing associations to work with local authorities to prioritise cases locally. The Department has moved away from a single, fixed grant regime, under which the financial returns to housing associations inevitably vary case-by-case. It has instead invited proposals from housing associations, up to the maximum grant rate, for the period to 2013-14. Despite the imperative to maximise the return from taxpayer funds invested through the Scheme, the Department has not yet developed checks to establish that the estimated rates of return within these proposals are reasonable.

Conclusion on value for money

19 The Mortgage Rescue Scheme has directly helped 2,600 households avoid repossession and immediate homelessness. These rescues cost in excess of £240 million, compared with plans to deliver 6,000 rescues for £205 million. The Scheme is likely to have delivered some wider social benefits, and the Department believes that it may have had some preventative effect in avoiding repossessions through financial advice and support offered to householders – but it has not measured these impacts.

20 In the way it implemented and managed the Scheme, the Department has not delivered value for money. The Department did not adequately test the assumptions underpinning the Scheme's business case; misjudged the demand for different types of mortgage rescue; and did not take action early enough to improve the value obtained from public investment in the Scheme after realising its initial assumptions were wide of the mark. Recent changes to the Scheme should reduce the up-front cost to the taxpayer, but also risk reversing earlier efforts to secure national coverage. Overall, therefore, the Scheme could, and should, have been significantly better implemented and managed.

Recommendations

21 When departments are under pressure to develop new policy interventions quickly there are often gaps in the evidence base. The Mortgage Rescue Scheme is a case in point. We make the following recommendations to the Department to reduce the risks to value for money under these circumstances – and increase compliance with the accepted principle that investment decisions should be based on solid evidence. These recommendations will also apply to other departments and public bodies.

a **The Department did not have a robust evidence base on which to base its estimates of Scheme costs and benefits, and did not adequately test the assumptions underpinning the Scheme's business case.** The Department should:

- draw more thoroughly on existing evidence and data (including similar schemes operating elsewhere);
- wherever possible, pilot schemes fully prior to implementation, and assess the results objectively prior to rolling out;
- if a pilot is not possible because of time constraints, as in the case of the Scheme, then:
  - identify the gaps in knowledge that the absence of a pilot leaves; and
  - engage directly with, and conduct original research on, specific target groups (such as householders) if necessary to test key assumptions;
- routinely and consistently subject its business cases, projects and programmes to independent external scrutiny; and
- present sufficient sensitivity or scenario analyses in key business case submissions and Impact Assessments to provide a full and transparent account of how costs and benefits could differ under alternative sets of assumptions.

b **The Department undertook analysis in support of individual changes to the Scheme, but did not take action early enough to improve value for money overall.** In the event of any material changes or proposed change to a policy instrument (such as changes to funding arrangements or eligibility criteria), whether before launch or in operation, the Department should:

- conduct a thorough analysis of the impact on unit costs and compare this cost to the expected unit benefit to assess whether the value for money case still holds;
- amend the analysis underpinning its initial appraisal documentation and resubmit its proposals for fresh scrutiny by its Investment Sub-Committee;
- where changes are sufficient to render the transparency function of the original published Impact Assessment obsolete (for example because initial cost or budgetary estimates have changed significantly), assess the case for carrying out and publishing a new Impact Assessment; and
- build formal review points into its Schemes so that, even where there is no explicit driver (such as a Spending Review), the value for money case is regularly and thoroughly scrutinised. It would be sensible to have these reviews after six months' operation, and then annually:
  - where there is compelling evidence that value for money is at risk, the Department should bring forward the next scheduled review;
  - the resultant decisions should be scrutinised and challenged by the Investment Sub-Committee; and
  - interim and full evaluations should be timed to inform these reviews.

c **The Department is continuing the Scheme based partly on an assumption that it prevents repossessions through providing access to money advice.** The Department should identify cost-effective ways to collect sufficient data to validate and quantify this impact, doing so from the outset in future schemes.

d **The Department is now relying on housing associations and local authorities to prioritise mortgage rescue cases locally and submit proposals for funds to progress these cases.** To assess the value for money of its share of the investment, the Department should commission the Agency to:

- develop, in consultation with housing associations, a standard financial model to benchmark housing association proposals for funding based on a set of standard assumptions; and
- use this information, as appropriate, to challenge any proposals if the returns do not appear reasonable.