Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

12 August 1980

M. Pattison
~~T. Lankester~~, Esq.,
Private Secretary,
10, Downing Street

Dear Mike,

HOUSING BILL: MORTGAGE ENTITLEMENT OF OLDER TENANTS UNDER RIGHT TO BUY

Your letter of 11 August invited the Treasury to prepare a factual analysis of the public expenditure consequences of available options for determining the mortgage entitlement of older tenants.

We have examined the following options:

A. Giving every tenant regardless of age an entitlement of 2.5 times current income

B. Giving the following age-related entitlements:

Up to and including 59	2.5
60) 61)	2.0
62) 63)	1.5
64	1.0
65 and over	1.0

C. A variant of B. giving a factor of 1.75 at 61 and 1.25 at 63.

The long-term public expenditure / consequences (in net present value terms) of these options in the case of a tenant on average earnings purchasing an average house are shown in the table below. (A separate note will be circulated as soon as possible setting out the assumptions on which these calculations are made.)

Public expenditure consequences in net present value terms of selling a typical council house to a purchaser aged 60-65

Age	Option A		Option B		Option C	
	Mortgage factor	NPV loss (-) or gain (+) £	Mortgage factor	NPV £	Mortgage factor	NPV £
60	2.5	- 3,600	2.0	- 3,600	2.0	- 3,600
61	2.5	- 4,200	2.0	- 4,200	1.75	- 4,000
62	2.5	- 4,600	1.5	- 3,800	1.5	- 3,800
63	2.5	- 5,100	1.5	- 4,100	1.25	- 3,400
64	2.5	- 5,800	1.0	- 3,000	1.0	- 3,000
65	2.5	- 6,500	1.0	- 1,100	1.0	- 1,100

These figures shows a significant net loss at age 60. The loss rises very considerably by age 65 under the DOE proposal of a 2.5 multiple for all ages (Option A). Option C is the most successful in reducing and stabilising the net loss.

The assumptions on which the calculations are based differ in two important respects from those which DOE published earlier this year for sales in general:

(a) No account is taken of net savings in improvement expenditure, on the grounds that these are less likely to occur in the case of older tenants.

(b) Account is taken of the lost opportunity to obtain vacant possession of the property when the surviving spouse dies. This must be done in order to reflect the true cost of giving supplementary benefit for house purchase, as oppose to giving it to meet rent payments.

The figures for 60 year olds in the table above suggest to us that sales to people in their late 50s may also entail a net loss. However the considerations in paragraph 5(a) become more important for younger people, while 5(b) becomes less important. In the time available it has not been possible to establish whether sales to people in their 50s would have more adverse consequences than sales to younger tenants, and we recommend that the taper (if any) should start at 60.

/We have

We have also considered the short run public expenditure effects. The following points are relevant:

(a) The Treasury's present public expenditure assumptions make no explicit allowance for sales to people of 60 and over. They assume that 30 per cent of sales in aggregate will be financed by deposits or private sector mortgages. They assume subsidy savings in the range £40-90 million a year.

(b) Some sales may be foregone if tenants cannot afford the deposit to bridge the gap between mortgage entitlement and purchase price. The mortgage factor has to drop below 1.8 for a deposit to be needed in the average case.

(c) A sale on a 100 per cent mortgage produces no immediate saving on capital account.

(d) If the mortgage payment is met by supplementary benefit, there is no public expenditure saving on current account.

(e) A mortgage entitlement of less than the purchase price could help public expenditure to the extent that it encouraged tenants to obtain a building society mortgage or a deposit from their own or their family's resources.

(f) Any increased take-up in supplementary benefit will correspondingly increase the revenue of local authorities who make the loan. But as paragraph 5(b) points out, they lose the reversion of the property.

Women Tenants

The above calculations are for male tenants. It seems likely that the pattern for 55-60 year old female tenants is broadly similar to that for 60-65 year old male tenants.

Recovery of supplementary benefit

It was suggested at yesterday's meeting that the problem could be got round by making supplementary benefit payments towards mortgage costs a charge on the dwelling recoverable from the tenant's (or his survivor's) estate. This would certainly improve the balance between gains and losses. We understand that this proposal would require primary legislation. It raises broader issues than that of the right to buy. It does not seem to be a practical option for the present. The Chancellor considers however that the idea merits examination.

I am copying this to David Edmonds and to the Private Secretaries to Mr Stanley and Mrs Chalker.

Yrs ever,
MH

M A HALL

PRIME MINISTER

PUBLIC EXPENDITURE EFFECTS OF A LOWER MORTGAGE/INCOME MULTIPLIER FOR TENANTS AGED 60-64

You asked that an attempt be made to assess the public expenditure implications of tapering the multiplier to be used in determining the mortgage entitlement of those aged 60 or more but less than 65.

No one can forecast the public expenditure effects with any real precision. What can be done is to make a calculation based mainly on (a) assumptions contained in the Department's published Appraisal of the Financial Effects of the Sale of Council Houses, (b) relevant experience of Building Societies and (c) relevant experience in the GLC. On (a), the Appraisal, and particularly the methodology used, has not been seriously challenged. On (b) and (c) these two sources provide as sound a factual basis as we are likely to get.

Two key points have come out of the calculations we have made since our meeting on Monday.

First, the proportion of the elderly likely to default is very small and the resulting additional liability to make Supplementary Benefit payments is insignificant in overall public expenditure terms.

On the basis of 100,000 sales a year (the broad PESC assumption) the number of those who would be buying in the 60-64 age range is likely to be around 6% - ie 6,000 purchasers. The Building Societies Association have given us a figure of 0.4% for the number of their mortgagors more than 5 months in arrears. The GLC have told us that of their 20,000 mortgages on former council houses only 200 or 1%, are in arrears of more than £300, and they have no tapering of their mortgage rules by age. The GLC consider that the incidence of mortgage default tends to decrease, rather than increases, with age. However, even assuming 1% of the 6,000 purchasers in the 60-64 age range default, one is considering what extra public expenditure on Supplementary Benefit might arise in respect of perhaps 60 people a year. Our calculation is that this is unlikely to reach more than £60,000 a year (paras 7-8 of the Annex).

Second, this small additional Supplementary Benefit liability is certainly going to be hugely outweighed by the public expenditure cost of making it impossible for elderly people to get a sufficient mortgage to buy at all.

Some 25% of council tenants have Building Society accounts. It has to be assumed therefore that most of the remainder will require a local authority mortgage in order to exercise their right to buy. If this factor is combined with the Treasury proposal to reduce the multiplier from 2½ to 1½, taking for example a £10,000 mortgage entitlement down to a £6,000 one, it might be assumed that perhaps half of the 6,000 prospective purchasers in the 60-64 age range may be unable to buy at all. Our estimate of the public expenditure cost of these lost sales is in the order of £8-10 million per annum. (The detailed calculation, based on that in the published Financial Appraisal of Council House Sales which was agreed with Treasry, is set out in paras 4-6 of the Annex).

If the 1½ time multiplier were to be applied to those in their 50's as well as to the 60-64 age group, the public expenditure cost of the much greater number of lost sales that would then result (perhaps 20,000 a year) would be of the order of £40-50 million a year.

The conclusions we draw are:

i. Although it has been necessary to make a number of assumptions the likely outcome is that the effect of a taper would be to produce far greater losses to the public purse through a reduction in sales than any likely public expenditure cost arising from mortgage defaults.

ii. The effect of extending a taper to those aged 50-60 (as opposed to those aged 60-64) would be to increase the public expenditure losses very greatly.

iii. Any form of taper based on age would produce considerable complexities and major anomalies that would be very difficult to defend politically. There are widely different practices over retirement ages eg as between men and women, phased retirements, or people working part-time or full time, when past retirement age. No taper based on age could reflect these different personal situations fairly.

iv. If the mortgage regulations result in many of the more elderly tenants being unable to buy, Labour Councils will be only too happy to tell disappointed purchasers that they are merely following the rules that the Government has laid down and that it is the Government's fault that they can't exercise the right to buy after all.

SECRETARY OF STATE FOR THE ENVIRONMENT

Our overall conclusion in the light of the further intensive work that we have done is that we should adhere to our original proposal for a multiplier of 2½ times income regardless of a person's age.

I am copying this minute to Geoffrey Howe and Lynda Chalker.

Paul Bristol
(Private Secretary)

M H
12 August 1980
(agreed by the Secretary of State and signed in his absence)

ANNEX

A

PUBLIC EXPENDITURE CONSEQUENCES OF A LOWER MORTGAGE/INCOME MULTIPLIER

A. The Number of People Affected and the Effect on the Number of Sales

Number of Purchasers

1. Murie found the following age distribution in his sample of sitting tenant purchasers:

Under 30	1%
30-39	19%
40-49	30%
50-59	37%
60-69	9%
70 and over	4%

(A Murie, Sale of Council Houses, Table 6.2)

Purchasers aged 60-64 are not separately distinguished from 65-69; but 6% would be a reasonable figure to take (out of 9% aged 60-69). If we take the PESC assumption of 100,000 sales a year, then there are assumed to be 6,000 sales a year to tenants aged 60-64.

2. The reduction in sales caused by a taper is taken for present purposes to be one-half. So the number of sales is reduced by 3,000 a year.

B. The Reduction In Savings to Public Expenditure as a Result of the Reduction in the Number of Sales

3. The reduction in the gains to public expenditure as a result of there being fewer sales may be worked out by the method described in the published Appraisal of the Financial Effects of Council House Sales. A particular uncertainty is the amount that the purchaser aged 60-64 with a local authority mortgage would put down in cash. There is no direct evidence to go on, but 30% would be a reasonable assumption; for the average for all first-time purchasers is 20%, but people aged 60-64 have had more opportunity to save.

4. The first year financial flows (at 1980/81 prices, as in the Appraisal) are:

Part of purchase price received in cash	+£2,520
Mortgage interest (at 15%, on £5,880)	+£882
Savings on costs of management and upkeep	+£43 to +£160
Rent foregone	-£416
Tax relief (at 30%)	-£265
Total first year financial flows	+£2,764 to +£2,881
	say £2,800

So with 3,000 fewer sales, there would be an adverse effect of about £8 million a year on public expenditure in this way.

5. But sales have continuing effects on the public purse. These effects arise from savings in costs of management and upkeep, rents foregone, and tax relief. What would happen would depend on the course of interest rates, inflation, and rents. The first two are very hard to predict; the third depends on policies. An approximate indication can be got by taking rents to rise at 3% a year in real terms, unchanged interest rates (15%), and 12% inflation. House Prices rise at 12%.

(figures in £ million)

	Year 1 (1980/81)	Year 2 (1981/82)	Year 3 (1982/83)	Year 4 (1983/84)	Year 5 (1984/85)
Cash sums received (3,000 houses a year)	7.6	8.5	9.5	10.6	11.9
Mortgage interest					
Sales in year 1	1.3	2.6	2.5	2.4	2.3
" " " 2	-	1.5	2.9	2.8	2.7
" " " 3	-	-	1.6	3.2	3.1
" " " 4	-	-	-	1.8	3.7
" " " 5	-	-	-	-	2.0
Savings on upkeep and management (*)	0.2	0.8	1.6	2.4	3.5
Total gains	9.1	13.4	18.1	23.2	29.2
Rent income foregone	0.6	2.2	4.1	6.6	9.8
Tax relief	0.4	1.2	2.1	3.1	4.1
Net total (out-turn prices)	8.1	10.0	11.9	13.5	15.3
Net total (revalued to 1980/81 prices)	8.1	8.9	9.5	9.6	9.7

Note: (*) Highest of the three variants in Table 6 of the published Appraisal

6. Even with faster increases in rents in real terms, the adverse effects on the public purse arising from 3,000 fewer sales each year would still run at about £8 million a year (at 1980/81 prices).

C. Supplementary Benefit Payments to Purchasers in Difficulty

7. The Building Societies Association advise that about 0.4% of all mortgages outstanding to building societies are 5 months or more in arrears. GLC advise that 1% of their mortgages on former council houses are £300 or more in arrears, three to six months according to when the house was bought. There are no figures relating to purchasers of any specific age. But if the GLC figure is taken, then 60 out of 6,000 purchasers aged 60-64 would be in serious arrears.

8. The reasons for arrears are not known; but if they were loss of income due to unemployment, illness, or injury, Supplementary Benefit would be payable. Mortgage interest counts as "rent" for SB purposes. Since in the circumstances the householder would normally have been entitled to Supplementary Benefit if he had remained a tenant, the extra expenditure on Supplementary Benefit arising because the householder is buying on mortgage is the difference between the amount of mortgage interest, net of tax relief, together with the SB allowance to owner-occupiers for maintenance, and the rent the householder would have been paying had he remained a tenant. From the figures in paragraph 4 the difference between net interest and rent in the year following purchase can be seen to be about £250 a year. Including the allowance for maintenance brings the figure up to about £300. So for 60 householders (paragraph 7 above) the amount is £18,000. With successive annual batches of purchasers, the number at risk would grow; but the rise in rents in money terms would narrow and then close the gap between mortgage interest and rent.
The total amount of extra SB (ie compared with what would be payable to the householders in question if they had remained tenants) as a result of interruption to income might reach £60,000 a year, but hardly more.

Housing

10 DOWNING STREET

PRIME MINISTER

Here are two briefs, from the Department of the Environment and the Treasury, concerning your meeting tomorrow morning on Housing (mortgage entitlement of older tenants).

D. J. T. Collinge

(Duty clerk)

12 August, 1980