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PRIME MINISTER

MORTGAGE INTEREST RELIEF

... I attach the note by my people which I mentioned to you. I know you won't like it, but I am bound to say that I find the case against an increase in the ceiling on mortgage interest relief pretty convincing. I have discussed this with all your Treasury Ministers. None of us believes that it would be right to raise the ceiling.

2. As you will see from the figures in the note, the costs of making a move would significantly affect the Budget arithmetic. To raise the ceiling to £30,000 could in the end cost about as much as a full percentage point increase this year in all the income tax thresholds, which would in practice be far more beneficial. Gains would go mainly to existing owners: because house prices would be pushed up, benefits to first-time buyers would be minimal.

why only first-time buyers.

3. I believe the politics point in the same direction. Any change on this front will increase our exposure to the charge that the Budget (like the income tax changes which we rightly made in 1979) leans too much in favour of the better off. And it would be criticised for favouring the "affluent South" to the disadvantage of the North.

/4. If you remain

4. If you remain unhappy about this, I will of course be happy to have another word. But I really do think that to increase the ceiling would be a mistake.

G.H.
24 February 1983

MORTGAGE INTEREST RELIEF

Costs of increasing the limits

1. The cost of mortgage interest relief in 1983-84 will be some £2.1 billion. The following table gives broad estimates of how the costs would rise if the ceiling were raised:-

– on what assumptions about take-up?

Increase ceiling to:	1983-84 cost	1984-85 cost (including initial extra borrowing)	Eventual* cost (at 1983-84 prices and income levels) including the effect of additional borrowing
	£m	£m	£m
£30,000	50-75	75-100	100-200
£35,000	75-100	100-125	200-300
£40,000	100-125	125-150	250-350
£60,000	125-150	150-200	350-450
£80,000	150-175	200-250	400-500

*This cost would build up over about 5 years.

If the ceiling were raised in line with average increases in house prices in the life of this Government it would be about £33,000.

– but what would it be if increased to its real value when it was imposed – £60,000?

Mortgages and house prices

2. The figures for building society average new mortgages show that the £25,000 ceiling affects only a minority of cases, and that these are concentrated in London and the South East.

it would, wouldn't it – there is such a penalty in going above £25,000 at present

Average new mortgages:
(Building Societies only)

	UK	Greater London	Rest of South East
	£	£	£
All buyers (Q4 1982)	16,900	22,600	20,100
First-time buyers (Q4 1982)	15,700	22,300	19,300

– if this is the average there must be many at or already above £25,000 in London & SE

The Inland Revenue estimate that out of nearly six million mortgages only about 100,000 to 150,000 are currently over £25,000.

3. House prices rose by 6 per cent from Q4 1981 to Q4 1982. The house price/earnings ratio is lower now (3.3:1) than at any time since the introduction of the mortgage interest ceiling in 1974 - at the end of 1973 the ratio was 4.5:1. Gross mortgage repayments for first-time buyers now average 20 per cent of income, compared with 27 per cent at the end of 1981, and 26 per cent at the end of 1973.

So what: — partly because interest rates have fallen since 81 & partly because of the £25,000 ceiling for the 73 comparison?

Gainers and losers

If so, it is surprising that the tax loss figures in para 1 are so high.

4. The main beneficiaries of a ceiling increase would be existing owners with big mortgages who would pay less tax. First-time buyers at the top end of the market might benefit for a time, but lower mortgage costs are likely to increase house prices (especially when the market is rising anyway). Raising the ceiling is thus unlikely to make housing cheaper for first-time buyers. ?

The effect of lower interest rates

5. The mortgage rate fell from 15 per cent to 10 per cent in 1982.

Are mortgagors to be blamed for historically high interest rates which they had no choice but to endure for 3 years.

So what?

- a purchaser taking out a £25,000 mortgage in December 1981 would have paid interest gross of £3,750, or net of tax relief at the basic rate, of £2,625;

- for the same house now, and allowing (generously) for a 10 per cent increase in mortgage to cover house price increases, a £27,500 mortgage would cost only £2,000 a year net despite the £25,000 limit;

- the £2,625 net he would have paid in December 1981 would now pay his net interest on a £33,750 mortgage.

Investment in housing or

Of course – it is one's home for life

Investment in housing or in enterprise

6. The tax treatment of investment in housing already compares very favourably with the treatment of investment in risk projects. Tax concessions to home ownership are already worth over £5 billion. In addition to mortgage relief, the sale of a taxpayer's main residence is exempt from capital gains tax, but other gains from investment are not, and tax and investment income surcharge is levied on the income they generate. As the Tax and Savings Group pointed out, this has channelled funds away from the equity market, raised the cost of capital, and so contributed to the decline in private equity and business investment, which we wish to stimulate. see comment on para 8

7. The following table summarises the contrast in treatment:-

	House	Own Business	Shares
Tax relief			
- on investment	No	Yes	No (1)
- on interest payments	Yes	Yes	No
Tax			
- on income from asset	No	Yes	Yes
- on capital gain from asset	No	Yes	Yes

Note:

(1) But relief is given at the company stage in the form of a capital allowance against corporation tax.

Monetary implications

8. A large part of mortgage lending is of course used to finance additions to the stock of owner-occupied houses, or to finance improvements. But most of the remainder undoubtedly ends up financing

/additional

This is inconsistent with the argument at the end of para 6: the Chancellor can't have it both ways!

spending or purchases of other assets. There are perfectly legal ways in which this kind of leak can occur. For example, a large part of the funds raised for housing inevitably accrues as cash in the hands of the last person in the chain, who is ceasing to be an owner-occupier; and tax relief encourages people to borrow more than they otherwise would, leaving more of their own funds free for other uses. and why not?

9. Total bank lending to persons rose by 45 per cent and bank lending for mortgages by 85 per cent in the year to January 1983. A recent Messels survey suggested that mortgage lending which becomes available to finance other forms of spending will amount in 1983 to some £7.2 billion. This is probably an over estimate: a figure of some £4-5 billion out of total mortgage lending of around £12 billion is more likely. But the impetus this gives to monetary growth, consumer spending and ultimately inflation is disturbing, and would increase if the ceiling on mortgage interest relief were raised.

because of a structural change in housing finance away from Building Soc's to banks

but we're not worried about our monetary growth - if anything it has been tight in 1982

Comparison between owner-occupiers and council tenants

10. Between 1979-80 and 1983-84 council rents will have more than doubled. Tenants will be paying some 80 per cent more from their own resources than in 1979. Most mortgagors will, however, be paying less in cash now than at any time since 1979 because of the fall in interest rates and because they still have the same mortgage.

from a very low base

11. As the following table shows, owner-occupiers have also done better from the subsidies under this Government. Mortgage tax relief has increased by 50 per cent while direct subsidies to public sector housing have halved.

	1979-80	1983-84
Council house subsidies	£1.95 billion	£0.85 billion
Mortgage tax relief	£1.4 billion	£2.1 billion

HM TREASURY
24 February 1983

23 FEB 1988

Personal

Feb 25th 1982

Prime Minister

Mortgage Interest Tax Relief

I am sorry to have to say that the Treasury note (Feb 24th) is economically correct. There is no faulting the economic case.

It would be best to concentrate all possible tax relief into raising the thresholds.

It is painful for me to oppose a measure on which you have such strong views — but I must.

Alan Walters