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Prime Minister

This is disappointing. But without computerisation (except in Scotland), it seems the best that we can do.

Agree the Chancellor's proposals?

D.

28/11

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

PRIME MINISTER

TAX RELIEF FOR INCREASED MORTGAGE INTEREST PAYMENTS

Following the announcement by the Building Societies Association, at the end of last week, that the mortgage interest rate was to be increased, Treasury Ministers have had urgent discussions with Inland Revenue officials about the effects on PAYE codings for the current tax year, 1979/80, and for next year.

2. As for 1979/80, we have come to the conclusion, somewhat reluctantly, that we should not ask the Revenue to perform a general re-coding operation to take account of new mortgage interest rates for the year ending 5th April 1980. To do so would add considerable pressures to tax offices at a time when their resources are already under great strain, and would put at risk the timely completion of the coding exercise for next year. As you will appreciate, there will be no uniformity in the dates from which the new mortgage interest rates will apply, as they will depend on the various Building Societies and the terms of individual agreements.

3. It will, however, be possible to implement new codes for Scotland, where PAYE is already computerised. The Revenue will also announce in a Press Release (draft attached) that they are prepared to change codes where a taxpayer specifically asks for it.

4. On that approach, the majority of 1979/80 codes

/ will

will remain based on a mortgage interest rate of 11¾ per cent, and the extra relief to which a taxpayer is entitled (about £25 on a £10,000 mortgage) will be taken into account at the end of the tax year. We have asked the Revenue to give priority to making these repayments, and again this point will be emphasised in the Press Release.

5. As for 1980/81, we have decided that the relief to be given in PAYE codings should be based upon an interest rate of 15 per cent - the new rate announced by the Building Societies. Should the rate fall during the year this will mean that too much relief will be given and that action will have to be taken by tax offices to prevent under-payments building up. It seems to me that there would be considerable presentational difficulties in adopting any other basis (for example by reference to an estimate of what the average rate might turn out to be), especially when we are not making changes for 1979/80.

6. If you approve the line I am proposing, I will instruct the Revenue to issue the Press Release.

(G.H.)

27 November, 1979

DRAFT PRESS RELEASE

BUILDING SOCIETY INTEREST RELIEF: PAYE

On 22 November, the Building Societies Association announced that the rate of interest would be increase generally to 15 per cent.

With the exception of new borrowers, tax relief in the 1979/80 coding is based upon an interest rate of 11¾ per cent, the rate in force when the codes for the present tax year were calculated. On 13 July the Building Societies announced an increased rate of 12½ per cent. Since that time this rate has generally been applied to new mortgages, but for existing mortgages it was to be applied from 1 January next. On a change of rate practices vary from society to society and therefore it is not possible now to estimate accurately in all cases the total interest payable for the current tax year on which relief should be given.

The staff in tax offices will be heavily engaged until next April in preparations for the new tax year 1980/81 and it would not be feasible to ~~review~~ rework for everyone's mortgage interest for 1979/80 before 5 April 1980. ~~even if the exact amount of interest were known in each case.~~ ~~But~~ The relief ~~is not lost:~~ will therefore come in a lump sum at the ~~at~~ the end of the tax year. At that time Building Societies will be sending reports of the actual interest payments to tax offices; ~~and~~ so long as any other adjustments do not wipe out the overpayment, the tax office will make a repayment as soon as possible thereafter and priority will be given to this work.

~~However,~~ if the above arrangements ~~are likely to~~ cause hardship to any taxpayer he should write at once to his tax office, giving ~~Provided that he can supply enough~~ full information ~~to enable an estimate to be made~~ of the interest actually payable by him for the year, his tax code will then be adjusted ~~promptly~~ as a matter of urgency.

Anyone who has taken out a mortgage since the rate increase was announced on 22 November will automatically have the correct interest included in his coding if he sends in full details with his claim.

28 NOV 1979

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Housing

10 DOWNING STREET

From the Private Secretary

28 November 1979

Tax Relief for Increased Mortgage Interest Payments

The Prime Minister has read the Chancellor's minute of 27 November on the above subject, and has agreed the substance of his proposals. But she is not altogether happy with the wording of the draft press release. She has suggested a number of changes to the third paragraph of the draft, which she would prefer to go out as follows:-

"The staff in tax offices will be heavily engaged until next April in preparations for the new tax year 1980/81 and it would not be feasible to recode for everyone's mortgage interest for 1979/80 before 5 April 1980. The relief will therefore come in a lump sum at the end of the tax year. At that time Building Societies will be sending reports of the actual interest payments to tax offices; so long as any other adjustments do not wipe out the overpayment, the tax office will make a repayment as soon as possible thereafter and priority will be given to this work. If the above arrangements cause hardship to any taxpayer he should write at once to his tax office giving full information of the interest actually payable by him for the year. His tax code will then be adjusted as a matter of urgency."

T. P. LANKESTER

M.A. Hall, Esq., M.V.O.,
HM Treasury.

TGR

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Housing

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

CONFIDENTIAL

cc Mr Wolfson

Prime Minister

My ref:

Your ref:

21 November 1979

I am pressing the Treasury to see if the Revenue can move faster than usual in changing people's tax codes: it normally takes months. On a £15,000 mortgage, net outgoings increase by £37 before the tax code is changed; £24 after the code is changed. TL 21/11

Dreadful news - how soon can we hope to reduce MLR by 1%.

Dear Tim

MORTGAGE RATE

We had a word yesterday evening, and I have spoken to Mike Pattison this morning, about the information that you had asked for on the likely effects of a mortgage rate increase tomorrow.

The Secretary of State saw Mr Leonard Williams and two of his colleagues from the BSA this morning for a general talk about the present situation. The Secretary of State made it clear that he was in no sense seeking to influence the BSA decision tomorrow, although he emphasised the importance of putting such a decision in the overall context of the national economic situation and the measures which were necessary in that situation.

He also sought the views of Mr Williams on the guidance that might be given by building societies on extending repayment periods in order to minimise the effect on mortgagors of an increase.

Mr Williams said that in the last few days many larger societies had seen a net outflow of funds. It was essential to offer savers a rate which would reverse this. The present rate for 7-day bank money was 15%; a building society saving rate of 10½% grossed up to that figure. And a 10½% saving rate implied a mortgage rate of 15%. Mr Williams added that at no time in the last 10 years had the building societies been at parity with the 7-day bank rate: they needed a higher level than that, over the longer run, to attract adequate savings. And the new national savings terms seemed designed deliberately to attract money from the building societies - perhaps in total £500m which would be withdrawn in two main blocks.

x Mr Williams said that the Council was only likely to agree on a 10½% saving/15% mortgage rate structure if there was a reasonable hope in their minds that market rates would begin to come down in the foreseeable future. It was likely that the higher rates would be

x i.e. it could go even higher

CONFIDENTIAL

offered immediately to savers and to new mortgagors, with most societies charging existing mortgagors the higher rate from 1 January.

Mr Williams said that most building societies would be unlikely to insist on increased repayments from mortgagors with normal annuity mortgages. In these cases the payment term could be extended. He would make this clear in public statements tomorrow. However, this was not an option for those with endowment linked mortgages.

Mr Williams added that he appreciated that there had been no question of a Government offer of subsidy or loan. But if he were to be asked a question as to whether the societies would have accepted such an offer, had it been made, he would answer that the view of the great majority of building societies was that in no way could such an offer be accepted.

I enclose the table on repayments, together with some short supplementary material which Mike asked me for this morning.

I am sending a copy of this to Tony Battishill in the Chancellor's office.

Yours ever

David Edmonds

D A EDMONDS
Private Secretary

Tim Lankester Esq
10 Downing Street

21 NOV 1979

MONTHLY REPAYMENTS ON A 25 YEAR ANNUITY LOAN £

Mortgage amount	(a) 11.75% gross	(a) 11.75% net	(b) 12.5% gross	(b) 12.5% net	(c) 14% gross	(c) 14% net	(d) 15% gross	(d) 15% net	% increase (i) (c) over (a) gross	% increase (i) (c) over (a) net	% increase (ii) (d) over (a) gross	% increase (ii) (d) over (a) net
£6,300 (current average for existing mortgages)	65.79	47.28	69.27	49.58	76.39	54.34	81.21	57.59	16.1	14.9	23.5	21.8
£10,000	104.42	75.05	109.96	78.71	121.25	86.25	128.92	91.42	16.1	14.9	23.5	21.8
£12,000 (current new mortgage)	125.30	90.05	131.95	94.45	145.51	103.51	154.70	109.7				
£15,000	156.63	112.57	164.94	118.06	181.88	129.38	193.38	137.13				
£20,000	208.84	150.09	219.92	157.42	242.51	172.51	257.81	182.84				
	existing mortgage rate for most existing mortgagors		mortgage rate recommended by BSA Council in July to take effect from 1 January 1980; already in effect for new borrowers.		indications are that the BSA will move to 15% immediately for new borrowers; and on 1 January for existing borrowers. At 14% rate increases the RPI by 0.6%		A 15% rate increases the RPI by 0.9%					

MORTGAGE RATE: "STRETCHING" REPAYMENTS

1. There are 5.3 million building society mortgagors. The considerable majority will have annuity or repayment mortgages. Some, percentage not known, will have endowment mortgages. 17% of new mortgages are now endowment mortgages.

2. Each monthly payment on an annuity mortgage is partly an interest payment and partly the repayment of capital. The interest payable is determined by the capital outstanding and therefore through the term of the mortgage, as the capital outstanding falls so the interest payable also falls. The proportion of each monthly payment that comprises interest falls,with the proportion comprising capital repayment rising accordingly.

3. If interest rates rise then a consequent increase in the monthly payment would generally be such to maintain the rate of capital repayment. If the monthly repayment does not increase to reflect increased interest costs then broadly the effect is to reduce or postpone capital repayment.

4. If the interest rate rise is considerable, or if a mortgagor is at the early stages of repaying a mortgage when the interest component is high and the capital component small, then there are limits as to how far an increase in monthly repayments can be avoided without increasing the mortgage debt. If repayments are not sufficient even to pay the interest on the outstanding mortgage loan then the unpaid interest can only be capitalised thus increasing the debt. This, broadly, has been the usual limiting factor on the rescheduling of payments when mortgage interest rates rise. The limit is reached earlier for those who have taken mortgages out recently because the capital component of their repayment, and therefore the impact of delaying capital repayment is smaller.

5. Whether a mortgage payment can be rescheduled is a matter between the mortgagor and his building society. It is understood that the BSA Council will recommend tomorrow that wherever possible member societies should reschedule payments. The more this is done the less will mortgagors have to increase their monthly payments. It is also possible that the Council will refer to the possibility of societies agreeing to capitalise interest payments in, for example, hardship cases. This will of course also have the effect of not increasing monthly payments but does mean that the mortgagor's debt is increasing and that in the

future he will, for example, not benefit from a fall in interest rates. Rather it is possible that his building society will ask him to maintain his payments in order to pay off capital faster and therefore return to the original repayment schedule.

6. A 25 year mortgage for £10,000 at 14.5% interest requires a monthly payment of £125.10 gross. The interest payments in the first year are £120.83 of that.

7. Endowment mortgagors pay only interest to the building society, the capital repayment being in effect reflected by premium payments to an insurance company. Endowment policies cannot be rescheduled. But the mortgagor can certainly negotiate with his building society to change to an annuity mortgage and that annuity mortgage will therefore enable him to gain the benefit of capital payment rescheduling.

8. Those with option mortgages can reschedule their payments up to a statutory maximum of 30 years.