BF 21/2

PRIME MINISTER

HOME IMPROVEMENT POLICY

The Department of the Environment have now circulated some revised proposals for inclusion in the Government's forthcoming consultation paper on home improvement policy.

In view of your serious doubts about the last version, I think that you will probably wish to take the chair yourself when the new proposals are discussed collectively. This will have to be after your visit to the United States, but it would be helpful meanwhile to have your guidance on attendance.

Those Ministers with a direct interest are as follows:

✓ Lord President (as Chairman of H Committee)
✓ Secretary of State for the Environment & Mr Gow
✓ Secretaries of State for Wales
    ✓ Scotland
    ✓ Social Services
✓ Chief Secretary
✓ Lord Privy Seal
✓ Paymaster General
✓ Minister without Portfolio

You may in addition like to consider inviting one or more Ministers with no departmental axe to grind.

Could you please indicate by a tick whether you would like any of the following present:

✓ Chancellor of the Exchequer
Secretaries of State for Defence
    ✓ Industry,
    ✓ Employment
    Energy
    Transport.

DRB.

13 February 1985

CONFIDENTIAL

Ce/10

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Summarised in paras 26-32

My ref:

Your ref:

11 February 1985

Dear David

Thank you for your letter of 21 January, recording the Prime Minister's reactions to the draft Green Paper on Private sector housing improvement policy.

In the light of discussions which we have had with you and with the Policy Unit, my Secretary of State and the Secretary of State for Wales have decided that the best way forward is to provide a policy paper, setting out the problems which we are aiming to tackle; the unsatisfactory nature of the present home improvement grant system; and the implications of introducing new systems of grants or loans. This I enclose.

You indicated that the Prime Minister was particularly concerned about the treatment of the loans options, which was included in the draft consultation document at the suggestion of the Policy Unit at a later stage after 'H' Committee had agreed the lines of the policies on which consultation should take place.

On the point of establishing those eligible to apply for help, you will see that we have now discarded the possibility, canvassed in the passage on loans, of relying upon the decisions of the lending Institutions. We propose to rest upon tests to be applied by local authorities.

Your letter also raised two issues not directly related to the arrangements for a grant or loan system. So far as the relationship between home improvement grants and support for the construction industry is concerned, this was one of the stated objectives, albeit short-term, of the announcement in the 1982 budget of increased rates for home improvement grants and more resources for local authorities to spend on grants.

Whether it is important to help those private householders who find the prospect of renovation work daunting, depends on whether the private sector housing stock is to be regarded as a national asset. This is the assumption on which successive Governments' have based their policies.

Much of the Chief Secretary's letter of 18 January also dealt with the question of loans. The paper covers the issues which he raised as well as those in your letter. We are discussing with the Treasury his further points on the paragraphs in the Green Paper dealing with clearance and redevelopment. We will circulate a revised passage in due course.

I am copying this letter to the private secretaries to members of H Committee, and to Richard Hatfield at Cabinet Office.

Yours ever,

Andrew

A C ALLBERRY
Private Secretary

David Barclay Esq

HOME IMPROVEMENT POLICY

NOTE BY THE SECRETARY OF STATE FOR THE ENVIRONMENT AND THE SECRETARY OF STATE FOR WALES

THE CONDITION OF OWNER-OCCUPIED HOUSING

1. The condition of the housing stock in England and Wales has been surveyed at broadly 5-yearly intervals since 1967. In 1981, there were 10.5 million owner-occupied dwellings in England and 0.6 million in Wales. The surveys carried out in that year showed that, of these, 2.5 million (23%) in England and 160,000 (27%) in Wales needed substantial improvement or repair work. The number needing major repairs (costing over £7,000 at 1981 prices) had increased from 314,000 in 1976 to 539,000 in 1981 in England and from 21,000 to 37,000 in Wales. The clear message was that statutory unfitness and increasing disrepair, rather than lack of basic amenities (bath, inside WC etc) were the major problems.

2. Many who live in poor housing are unaware of how much work needs doing. Fewer than 5% of those living in houses below the statutory fitness standard regarded them as "very bad". Even where the shortcomings were obvious, many, and in particular elderly people on low incomes, had no intention of putting them right.

3. Those whose houses are in greatest need of improvement or repair differ from the generality of owner-occupiers. They tend to live in their homes much longer (about 20 years compared with 7 years); are more likely to be above retirement age; and to have much lower incomes. In 1981, two thirds had gross incomes of less than £80 per week, compared with the then national average income of £115 per week.

THE PRESENT BASIS OF PUBLIC SECTOR INTERVENTION

4. Help is currently given to private householders by a system of mandatory grants for the installation of basic amenities and where local authorities have served notices, and by discretionary grants for major repairs and improvements. There are eligible expense limits, and maximum grant levels ranging from 50% to 90%. Eligibility is confined to those with Rateable Values (RVs) below £400 in London and £225 elsewhere.

5. Even in 1983-84, when a record 280,000 grants totalling about £1000 million were paid in England and Wales, spending on grants representedonly about 10% of total private sector expenditure on home improvement, maintenance and repair. At present about 14% of owner-occupiers are eligible for grants.

6. The objective since 1974, more strongly emphasised in 1980, has been to concentrate public help on the worst properties and on those households in greatest need of help. But while the existing system directs grants to the worst housing, it fails to exclude all those who could afford to finance essential works themselves (many of whom have indicated that they would have gone ahead without grant); and it fails to include many who cannot do so - essentially, because RVs are an inadequate test of ability to pay. The system therefore does not direct resources to those in greatest need and in some cases simply substitutes public for private expenditure. This lack of cost-effectiveness has been criticised by the Public Accounts Committee.

THE FUTURE BASIS OF PUBLIC SECTOR INTERVENTION

7. On 17 October "H" Committee approved (H(84)18th meeting) proposals

by the Secretaries of State for the Environment, Wales and Scotland (H(84)28) for revised policies to secure the repair and improvement of private housing and to improve the cost-effectiveness of Government assistance. The Secretaries of State were invited to produce separate documents for England and Wales and for Scotland setting out these policies for the purpose of consultation. The draft consultation document for England and Wales was circulated to "H" Committee members on 7 January.

Objectives

8. An important objective of the proposals in the draft consultation document is to encourage increased private expenditure. Responsibility for repair and improvement should rest first and foremost with individual householders, and it is important to maintain spending on repairs so that the problems revealed by the 1981 survey do not become worse. The proposals in the consultation paper on warranty schemes (para 15) and agency services (paras 21-24) are designed to encourage private householders to spend their money and to marshal the support of the lending institutions.

Eligibility for Help

9. But some people are too poor to borrow and do not have enough savings. They need financial help to carry out timely repair and renovation, especially if their property is in a bad state. Where such public support is necessary, the targeting must be significantly better than that achieved by the present RV-based system. And the test of ability to pay must be cheap to administer and should not deter applications from those we are anxious to encourage.

10. Our preferred method, agreed by "H" Committee, is, first, to passport those eligible for Family Income Supplement (FIS) and Supplementary Benefit; and for others, to apply a test of income and savings, broadly of the kind adopted by banks and building societies (who should be the primary source of funds for private householders who need to borrow to fund repairs or improvements). These tests would apply whether help was mandatory, or discretionary. Those below the test levels of income and savings would be eligible to apply for help. The extent of help would be determined by applying a tapering system which related costs to resources as a broad indication of the ability of individuals to meet at least some, if not all of the costs themselves. These proposals may be criticised as adding to the body of generally unpopular means-tested benefits. But help for home improvement or repair is different from income support benefits in being one-off and for substantial amounts, running into several thousands of pounds. The eligibility test and the tapering system are described in paragraphs 9 to 14 of Annex III to H(84)28.

11. Old age pensions are not of course means-tested and therefore do not constitute a criterion for accurate targeting. Nonetheless, there would be some political attraction in making OAPs automatically eligible without a means test; and OAPs do of course include a large proportion of the poorest people in the worst houses. This is particularly the case in Wales. However, to "passport" OAPs would include 120,000 OAP households nationally who we estimate could afford to do the work. Accordingly, when "passporting" of OAPs was suggested by the Secretary of State for Wales, it was rejected by H Committee (page 4 of H(84) 18th meeting). Alternatively, confining mandatory grants to OAPs, would exclude

61% of those living in the very worst housing, unable to finance the necessary repairs or improvements, for whom help would then depend upon applying for discretionary grants.

12. Under our preferred method a further 100,000 owner-occupiers would become eligible and 300,000 would be removed from eligibility leaving a total of around 1.3m eligible in principle. This would include 630,000 OAPs (84% of OAPs living in property whose condition justifies either mandatory or discretionary help).

Form of Help

13. The proposed test identifies those eligible to apply for help - because they are unable to fund all or part of the works from savings or conventional borrowing. Consideration then needs to be given to the form the help should take.

Grants

14. Our preferred option is to continue with a system of grants, as described in paragraphs 29-30 and 34-36 of the draft Green Paper. Home Improvement Grants are familiar to applicants and administering authorities. The changes could be justified on grounds of more cost-effective use of resources (an aspect on which the present system has been widely criticised), following a deliberate, short-term boost to expenditure under the present system. It would be difficult for critics to suggest that the form of help *per se* represented any lessening of commitment by the Government, either to the repair and improvement of the private sector housing stock as a whole, or to the help given to those

marginal purchasers who have moved into home ownership at the lower end of the market. The increasing and disturbing trend towards disrepair in the private sector stock, even under the present system, justifies maintaining a grant system for people and dwellings most in need, to prevent costlier public expenditure in the future.

Loans

15. A more radical alternative, which over the longer term would save money but which would be much more controversial, would be to replace grants by loans. Before assessing the advantages and drawbacks of this approach there are two issues to be considered about the form of loans.

16. The first is the timing of repayments. The proposed test of eligibility coupled with the operation of the taper is designed to bring in Government help only when individuals are judged to have exhausted their capacity for commercial borrowing involving regular payments. Loans from the public sector would, in effect, be "top-up" loans and repayment of them would have to be financed from the value of the property when it is realised. An exception to this general pattern would be premature redemption by individuals whose financial circumstances had significantly improved.

17. The second issue is the terms of repayment. The amount to be repaid could be the cash sum advanced or this amount plus deferred interest or a sum linked to an equity share in the property.

18. To require a return on the public investment would recognise that any increase in the value of the property attributable to

that investment would be a windfall gain to the owner. Deferred interest or equity share loans would in principle therefore be "fairer" to tax payers as a whole, as well as producing more public sector receipts.

19. The advantages and disadvantages of adopting loans, and the choice between different forms rest upon:

- the size and timing of public sector receipts;

- the administrative arrangements; and

- the effect on take up by those we are anxious to encourage to carry out essential work.

Expenditure Implications

20. Loans, like grants, count as public expenditure when they are made. Savings in public expenditure would materialise only when loans were repaid. On the basis of the assumptions and method of calculations set out in Annex A the following table illustrates for England and Wales the relationship between expenditure and capital receipts, at certain points over a 20-year period, for a cash expenditure of £100m in year 1, increasing by 3% a year. It is based upon data relating to English and Welsh grant recipients under the present system. Despite the relatively poor targeting of this system, it directs the majority of grants to those who, as a whole, tend to remain in their homes for longer than the generality of owner-occupiers. This tendency is more pronounced in Wales. Improved targeting would increase this effect, thus extending the time-lag before loan repayments produced significant

receipts. The table therefore overstates the potential benefits under the proposed new system of targeting on the poor.

Interest free loans

	Capital receipts in year from loan repayments (England)	(Wales)	Spending in year on new loans
Year 5	£18m	£ 6m	£113m
Year 10	£38m	£13m	£130m
Year 20	£89m	£40m	£175m

Equity-linked or deferred interest loans

	(England)	(Wales)	
Year 5	£19m	£ 6m	£113m
Year 10	£45m	£15m	£130m
Year 20	£128m	£60m	£175m

Administrative arrangements

21. Annex B describes the administrative arrangements necessary to operate the various types of loan. These are all to a greater or lesser extent more complex, and thus more costly to administer, than a grants system. A number of difficult issues arise: for example, dealing with transfers by inheritance rather than sale; selecting an interest rate which, when rolled up, does not result in a debt greater than the value of the property; accommodating charges or equity shares where the property is already the subject of bank or building society charges.

22. None is intrinsically insuperable. But they add to the complexity of the system, at a time when one of our declared aims, set out in the draft Green Paper, is to simplify an already over-complex system; to reduce running costs; and to improve take up. They would involve additional burdens upon the local authorities.

The disadvantages of loans

23. Under the present system of grants, far fewer elderly people and people on low incomes apply for help than the numbers eligible would suggest. Loans would be much less attractive to them than grants. The elderly in particular are well known to be reluctant to put themselves into debt. They usually own their own homes outright, which they prefer to pass on to their heirs unencumbered. Introducing loans will therefore be strongly attacked as making it even less likely that elderly people will apply for help. They would be perceived as a weakening of the Government's commitment to the repair and improvement of private housing.

24. This disincentive effect will be even greater with equity-linked or deferred interest loans, if it is perceived that the amount to be repaid will gradually increase. With an equity-linked loan, the owner will know what proportion of the value of the property he or she will have to pay to the local authority. With variable rate deferred interest loans, there will be greater uncertainty. Doubts about taking on a loan of this sort may deter many low income home-owners from embarking on repair or improvement at all.

A mixed system

25. A possible compromise would be a system which provided grants

where mandatory help was appropriate (ie for the worst housing) and loans for discretionary help. This would reduce the disincentives for the 40% of those capable of passing the test of eligibility who are possible candidates for mandatory help. But it would reduce the potential for public sector receipts; and it would further increase the complexity of the system and add to the work and costs falling on the local authorities.

SUMMARY AND CONCLUSIONS

26. The present system is inefficient. A third of those eligible could afford the necessary work without public sector help, but over 100,000 owner-occupiers who cannot afford essential improvements or repairs are ineligible. A new approach is needed to improve the cost effectiveness of public sector help. The principle should be that help is limited so far as possible to those householders who could not afford themselves to finance essential improvement or repair from savings or through bank or building society loans.

27. A simple "passporting" system - confining eligibility to those in certain groups, such as Old Age Pensioners or those receiving Supplementary Benefit or Family Income Supplement - would exclude many of those in need of help, who do not come within these categories.

28. For these reasons, we continue to favour the incomes and savings test, approved by 'H' Committee on 17 October. Such a system would secure a broadly satisfactory targeting of help on those who need it, without the complications associated with full means testing of the kind used for Supplementary Benefit. We

believe that the decision to adopt such a system could be justified.

29. For the form of help for those found eligible, the choice is between grants and loans. Both count as public expenditure, and whichever is adopted there is no case for making help available to those who can afford to do the work themselves.

30. Interest-bearing or equity-linked loans are fairer to tax-payers as a whole. They will also generate capital receipts. However, because of the slow turnover of property among those concerned, these will remain low for several years. Against this have to be set the undoubted disadvantages. They would be cumbersome for local authorities to administer. They would also deter many of the very people, particularly the elderly, whom we want to help. They would certainly be criticised as a substantial weakening of our commitment to helping owner-occupiers to carry out essential repairs and improvements, and to the encouragement of home ownership.

31. A mixed system of grants and loans produces some reduction in disincentives to take up; but at the cost of lower receipts and increased burdens on the local authorities.

32. On balance we recommend a well targeted system of grants, which would offer clear gains in cost effectiveness, and simplicity of administration and which holds out the prospect of satisfactory levels of take-up.

LOAN REPAYMENTS

1. In calculating the capital receipts which would be produced by home improvement loans the most important assumption is the proportion of loans repaid in each year. Distribution of Grant Enquiries carried out in England and Wales in 1983 collected information about the length of time that those who had received home improvement grants intended to remain in their homes. Based on this evidence we have assumed that in England 3½% of the loans given in any year would be repaid in each subsequent year. The equivalent Welsh data indicate that a lower figure of just over 1% a year in the earlier years should be adopted. The annual average rate of repayment of normal bank and building society mortgages is 5%. But the characteristics of those who would be eligible for loans for improvements and repairs are very different from the generality of mortgagors; they will tend to be older and on lower incomes. Indeed, it is likely that the better the targeting of loans on those who need them most, the slower the rate at which the loans would be repaid.

2. For the purposes of the calculations we have assumed an inflation rate of 3% a year, and that the amount spent by local authorities on loans rises in line with this.

Interest-free loans

3. The capital receipts which would accrue under a system of interest-free loans are the product of these two assumptions. While authorities' new lending on loans rises gradually to compensate for inflation, the repayments which are being made cover only the original cost of the loans.

Equity-linked and deferred interest loans

4. With loans which are linked to a share of the equity, we have assumed that house prices rise on average by 1% more than the overall rate of inflation - ie 4%. This means that the amount owed to the local authority rises by the same amount.

5. The level of market interest rates is likely to run above both the rise in prices generally and also the increase in property values. However, to charge deferred interest at a rate above the rise in house prices would mean reducing an owner's share of the value of his property, and could in due course mean that the debt exceeded the total value of his home. To avoid this problem, we have assumed that the rate of deferred interest is held to 4% a year - equal to the assumed average rise in house prices. On these assumptions the same capital receipts would be produced by deferred interest loans or by equity linked lending.

6. The assumptions about inflation and the rise in house prices have been set after discussion with the Treasury.

ANNEX B

ADMINISTRATION OF LOANS FOR HOME IMPROVEMENT AND REPAIR

Matters common to all loans

1. For all loans, the local authority would register a charge against the property at the time the loan was given. The owner would need to clear this and any other charges in order to sell with good title. The amount due to the local authority would therefore be paid out of the proceeds of the sale, as already happens with a bank or building society mortgage. Where the property for which the local authority loan was made was already the subject of a bank or building society mortgage, the local authority would register a second charge. If the existing mortgage were large, the selling price of the property might not be sufficient to pay back all that was owed to the local authority.

2. It would be necessary to decide how to treat transfers of ownership within the same family (for example to a son or daughter on the death of a parent). Local authorities could require payment in such circumstances. If they did, the person inheriting the property would probably have to sell in order to raise the money. On the other hand, an exemption is given to the requirement for repayment of the Right to Buy discount where the house is passed on to a member of the same family.

3. With all types of loan a major issue which arises is whether there should be any reduction in the amount to be repaid where the value of the loan is greater than the increase in the value of the property which results when the improvement or repair work is carried out. For example, work costing £5000 to a property previously worth £15000 might raise its value only to £18000 (the £2000 difference is the so-called 'valuation gap').

4. One way of avoiding this problem would be to assess the pre- and post-improvement value of the property, and to ensure that any borrower was not required to repay an amount which reduced his share of the equity. However, householders would often need to borrow from a bank or building society, as well as taking out a local authority loan. If the loan system included a valuation

of the property, there would be obvious complications in calculating the amounts attributable to the local authority and the private sector loan where both had been used to finance a single package of work.

5. Owners would need to be given the possibility of repaying the loan before the house was sold, if they could raise the money and chose to do so.

Interest-free loans

6. Providing house prices continue to rise, the 'valuation gap' would affect only those recipients of interest-free loans who repaid within a year or two of carrying out the work. If it were felt inequitable in such a case to expect the owner to repay an amount larger than the increase in the value of the house, it would be possible to offer partial remission of loans repaid in the first few years. Alternatively a valuation system, of the sort described above, could be used. The amount to be repaid would be reduced where the difference between the pre-improvement value of the property and the selling price was less than the size of the loan. The local authority would have to be satisfied that the price at which the house was being sold was the maximum which could be obtained.

Deferred interest loans

7. Where interest was being charged, repayable when the house is sold, it would be necessary to consider very carefully what the rate of interest should be. Unless this is kept below the rise in value of the house for which the loan had been given, the owner will find his share of the equity shrinking. In some cases, owners could find that they owed the local authority more than the full value of the property. For example, on the not unreasonable assumption that market interest rates ran 4% a year ahead of the increase in house prices, an owner taking out a £10,000 deferred interest loan on a property with a post-improvement value of £20,000 would find that, within 20 years, he owed the local authority more than the house was worth.

8. This suggests that deferred interest loans will need to be

offered at less than market rates. The rate charged will also need to be variable, certainly over time and probably between areas of the country (if price rises are not uniform across all regions). There will still be a risk to the home-owner whose house increases in value by less than the national or regional average.

9. The owner would need to be told of any change to the interest rate being charged, and be informed regularly of the total debt outstanding. This could be in a form similar to the annual statements sent to bank and building society mortgagors.

10. Tax relief is normally available on the interest on loans for improvements and most types of repairs. If the rate of interest being charged on deferred interest loans were at less than the full market rate, it might be felt appropriate to exclude such loans from eligibility for tax relief. But if relief were to be offered, this would presumably be on a MIRAS-type system under which the local authority calculated the increase in the outstanding loan net of tax.

Equity sharing loans

11. With equity-sharing loans, local authorities would always need to carry out a valuation of the property to assess the share of the equity which they should take. If it were decided to take account of the possibility that the cost of the work would not in all cases be fully reflected in the increased value of the property, both pre- and post-improvement values would need to be assessed.

12. Taking out a charge on the property related to a share of the equity would be highly unusual and could present some difficulties, though it should be possible to achieve it.

13. Some people will continue to live in their homes for a very long time after the loan has been paid. The local authority will benefit from the rise in value resulting from subsequent improvement work which such owners carry out and finance themselves, unless further valuations are carried out to allow the increases in value attributable to such work to be disregarded when calculating

the amount due to the authority.

14. The local authority would need to be satisfied that the maximum possible price was being obtained for the property when it was sold. It might be necessary to allow the District Valuer to assess the selling price, if the authority felt that the owner was attempting to sell it cheaply.

15. Although the equity share would be an alternative to charging interest, it would not seem possible to give the owner the benefit of tax relief on the increase in the value of the equity share over time - effectively the interest on the loan.

[illegible] FEB 1985