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PRIME MINISTER

PRIVATE RENTED SECTOR DEREGULATION

I have reviewed the new H Committee recommendation to Cabinet (27 February 1985). The decision to deregulate not only rents but also security of tenure is based both on sound reasoning and reasonable interpretation of the evidence.

In this decision both H and Cabinet apparently were not misled by the absurd arguments, figures and omissions in the Annex to the Department of the Environment's memorandum. From my review of the data, it is clear that there is virtually certain to be a substantial reduction in future PSBR, although it is conceivable that the first year or two might see a very small increase - certainly well below any of the erroneous forecasts produced by DoE. But, much more important, as shown by Christopher Monckton's cost-benefit calculations, there would be very large net benefits from such a policy. This cost-benefit calculation is the only reliable criterion by which policy should be judged.

With the present housing benefit (HB) system, and with the new private rental arrangement, the proposal will involve a small (gross) increase in public spending in the short run. In the long run the multitude of benefits from reduction of public sector provision, increased mobility of labour, reduction of unemployment, increased productivity and new incentives will more than offset such initial effects on public expenditure.

Furthermore, this small and temporary gross increase in public expenditure - offset in the medium to long term by large PSBR savings, even on DoE's ungenerous assumptions - would be one of the few increases which can be justified because they are designed to make the market work and expand freedom of contract.

It would be inequitable and discriminatory to exclude new tenancies from housing benefit. And the new free-to-let

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initiative will fit neatly into the Housing Benefit Review's suggested policy of changing HB so that the present incentives for waste and wanton occupation are at least substantially modified. Also, the Review's proposed reductions in HB will, of course, reduce still further the already small short-term costs of deregulation. In the long run the new system of benefits should ensure that people would receive benefits only because, in spite of their best efforts, they remain poor - rather than because they choose to occupy valuable and expensive property. But providing a viable and healthy rental market is an important step on the way to this reform.

Finally, the H proposal for full deregulation of the private rented sector is consistent with the principle of morality that lies at the centre of your policy - people should be allowed to enter into mutually advantageous arrangements or contracts without state intervention to "protect" one party or to intimidate another. The "grandfather clause" protects existing tenants and prevents disruption. The new proposal has all the characteristics of a reasoned argument for freedom of contract by mutual consent.

AW

ALAN WALTERS
12 April 1985

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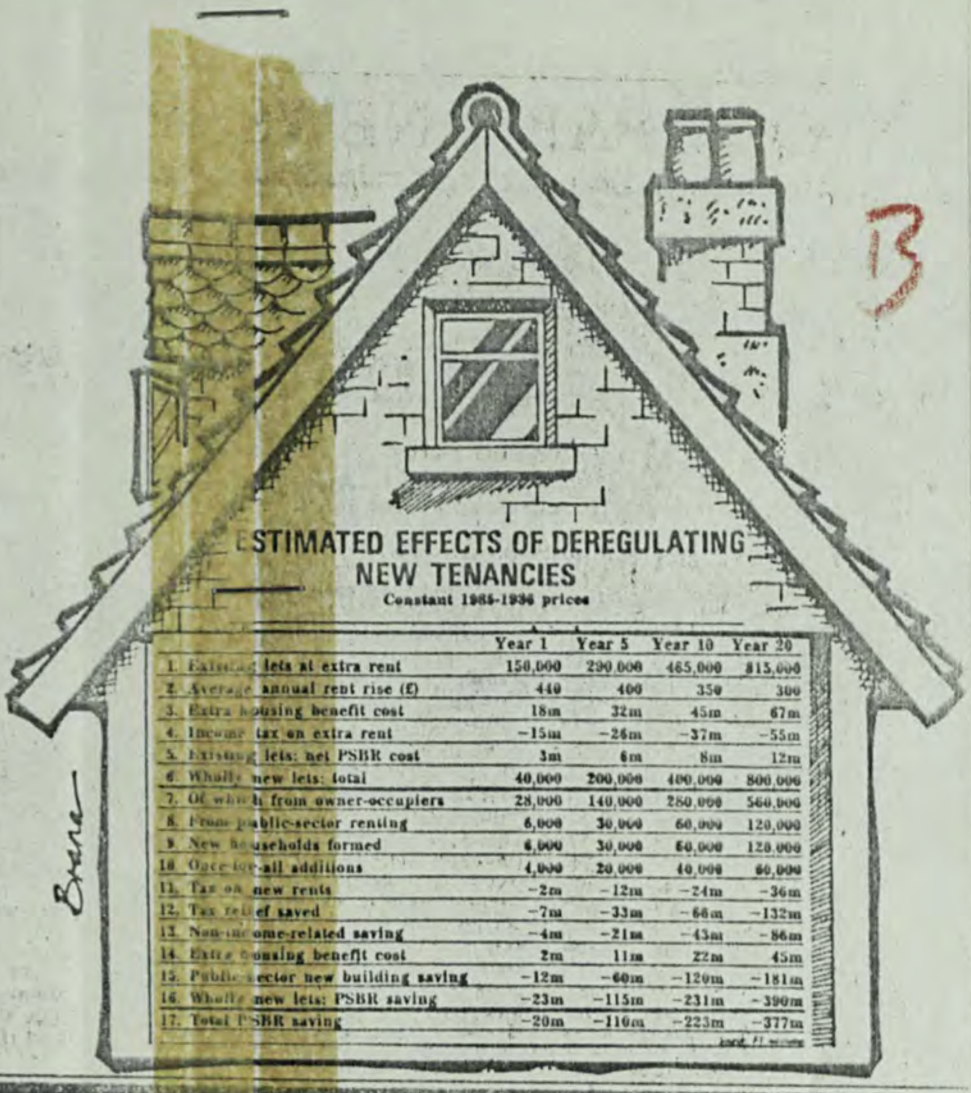
Economic Viewpoint

More homes to let: a test of political courage

By Samuel Brittan



ESTIMATED EFFECTS OF DEREGULATING NEW TENANCIES
Constant 1984-1985 prices

	Year 1	Year 5	Year 10	Year 20
1. Existing lets at extra rent	150,000	290,000	465,000	815,000
2. Average annual rent rise (£)	440	400	350	300
3. Extra housing benefit cost	18m	32m	45m	67m
4. Income tax on extra rent	−15m	−26m	−37m	−55m
5. Existing lets: net PSBR cost	3m	6m	8m	12m
6. Wholly new lets: total	40,000	200,000	400,000	800,000
7. Of which from owner-occupiers	28,000	140,000	280,000	560,000
8. From public-sector renting	6,000	30,000	60,000	120,000
9. New households formed	6,000	30,000	60,000	120,000
10. Once-for-all additions	4,000	20,000	40,000	60,000
11. Tax on new rents	−2m	−12m	−24m	−36m
12. Tax relief saved	−7m	−33m	−66m	−132m
13. Non-income-related saving	−4m	−21m	−43m	−86m
14. Extra housing benefit cost	2m	11m	22m	45m
15. Public sector new building saving	−12m	−60m	−120m	−181m
16. Wholly new lets: PSBR saving	−23m	−115m	−231m	−390m
17. Total PSBR saving	−20m	−110m	−223m	−377m

THE ACID TEST of the Thatcher Government's sincerity in pursuing supply side policies to help people find their own jobs will be with us very shortly. It arises on an issue where, for once, free market economics coincides with the Government's own policy instincts; where the arguments for action are overwhelming, and the number of potential sufferers extremely small, if the reform is carried out competently.

The key is to be found in a motion on rent controls moved by Peter Hordern, a Conservative MP, on March 8 and supported in a personal capacity by Peter Lilley, the Chancellor's Parliamentary Private Secretary. Mr Hordern made clear that he expected protection for existing tenancies to continue and that he had in mind only decontrol of new tenancies, a road along which Germany and France have already travelled. It is with this possibility in mind that Ministers are engaged in a review of the private rented sector.

The withering of the private rented sector is second only to over-rigid labour markets as a cause of high unemployment. A young person moving from a high unemployment region like Liverpool to a more prosperous area may well not be able to afford to buy a new house, or may rightly hesitate to tie himself down straight away. He will have almost no chance of a council house in view of the long waiting lists.

The most natural form of accommodation for him would be private sector renting. Yet, because of rent controls private landlords do not have any incentive to provide such accommodation. On the contrary, the landlord has every inducement to sell rented property for owner occupation as soon as it becomes vacant. The stock of private rented dwellings is less than 2m and is shrinking by at least 70,000 a year.

Private sector lets have fallen from about 90 per cent of all accommodation in 1915, when rent control was imposed, to 45 per cent in 1950 and less than 10 per cent today. (In the U.S., it is still well over 30 per cent, in Switzerland over 60 per cent.

Because rents are so far below free market levels, other wastes proliferate. One example is under-occupation. When children grow up, parents find it does not pay to leave for smaller accommodation. Landlords, on the other hand, are tempted to leave rented property in disrepair and dilapidation.

Because there are now so few new lets more and more people now depend on bed and breakfast accommodation, or are placed in hostels of varying kinds, or simply sleep rough. All these abuses have increased manifold since the Labour Government atavistically extended control to furnished accommodation in 1974.

A graphic illustration of the effects of rent control was given in a recent letter to the Standard newspaper by a reader who would have been prepared to spend £5,000 to convert some rooms into a self-contained flat if he could have charged £30 per week. The interested tenants were a couple forced to live in bed and breakfast accommodation costing them £40 a week *each*. So they too would have gained. But as the landlord could not expect to recover more than £13 a week under a regulated "fair rent," the whole project had to be abandoned.

Some Government faint-hearts have put forward as a pretext for inaction largely imaginary PSBR costs of decontrol of new tenancies, arising from greater eligibility to housing benefit.

On any assumptions, rent decontrol is about the cheapest form of job creation imaginable. Treasury Ministers, who favour housing mobility, are emphatically not citing PSBR costs as an obstacle.

The real worry of Cabinet faint-hearts is, of course, different. It is the fear that the Conservatives will be associated once more with Rachmanism, harassment of tenants by landlords, and with bad memories of the last major decontrol Act of 1957. The big difference, however, is that while the 1957 Act applied to sitting tenants, new legislation today would apply only to new tenancies. It could and should also be accompanied by measures to give existing tenants more protection against harassment.

Deregulated new tenants would be protected from being thrown out on the street in the event of a failure to agree a new review by the Protection from Eviction Act of 1977. An additional safeguard might be for new tenancies to be fixed for agreed periods between landlord and tenants, instead of the indefinite arrangements customary in this sector.

The other *immobiliste* argument is that landlords would hesitate to let for fears that a Labour Government would reimpose controls. It is best to concede that the main benefits would come after an election—although it would be wise to have any new Act in operation for a year before, just to disabuse the prophets of horror. It would also help if the SDP could avoid being as conservative as Labour and, however many disapproving noises it made, avoided outright repeal commitments and concentrated on the need for a more balanced overall housing policy. At the end of the day, however, the better any new legislation is seen to work, the less the chance of repeal by a new Parliament.

The accompanying table is an entirely unofficial attempt to estimate some of the principal consequences of deregulating new tenancies.

The starting point is the 1981 Labour Force survey showing some 300,000 private sector lets expiring each year. This figure needs to be reduced because of "loophole lets" (eg. to companies) or lets on which housing benefit is not claimed. The number of new tenancies at higher rent on which benefit would be paid has, therefore, been reduced to 150,000. But not a great deal hangs on this reduction, as the benefit cost would be substantially offset by income and corporation tax on the extra rents. After 20 years about half the existing controlled tenancies might be eliminated, and after 50 years the whole lot.

Officially registered rents in London averaged in 1984 just over £1,100 per annum for unfurnished dwellings and nearly £1,600 for furnished. Outside London they were £775 and £1,150 respectively. The initial rent rise on new tenancies could range from 50 to 100 per cent in London to near zero in some areas where market forces would not allow an increase. An average increase of £440 has been written in for the whole country. This figure (measured at constant prices) will clearly decline as supply increases.

The more interesting lower half of the table makes an estimate of the new lets, which greater freedom would stimulate. The total rented stock is assumed conservatively to rise by about 2 per cent per annum until it has increased by one-half. This gives 40,000 new lets per annum of which 70 per cent might be in place of owner occupation, 15 per cent in place of council tenancies, and 15 per cent arising from newly stimulated household formations. Another 4,000 new lets per annum might come from previously vacant properties, until 60,000 of these were absorbed.

The following lines show resulting Exchequer gains: from taxes on new rents, savings in mortgage interest relief and from savings in, for instance, improvement grants, which are less in the privately rented sector.

The final result is a modest PSBR saving of just over £20m in the first year, rising to over £200m per annum in the tenth year and to nearly £400m in the 20th. The real present value of the savings discounted over 50 years may be between £5bn and £9bn (at 2½ to 5 per cent real discount rates).

Whitehall's estimates probably differ from the table by showing a small PSBR cost in the early years. More pessimistic assumptions might be made, for instance, on initial rent increases, and on income tax gains. There might be political obstacles to reduced council house building, or to the changes in housing benefit recommended by the recent inquiry.

On the other hand, the table is itself very cautious on many key assumptions, above all the number of new lets once it is clear that deregulation is here to stay for some while.

Even on the most pessimistic assumptions, the initial PSBR cost in the early years couldd hardly be more than £30m to £40m per annum. This is 1 per cent, not of the PSBR, but of the estimated *error* in forecasting the PSBR. It would be recovered in increased tax revenues if the national income rose *once-for-all* by 0.03 per cent as a result of greater mobility and more jobs.

But even without counting on any GDP gain whatever, almost no adjustments could prevent the PSBR effect becoming favourable after a very few years and having a very large present value. Anyone who cites the PSBR effects as a reason for not deregulating new tenancies is thus using it as a cover for lack of political nerve.

A proper housing policy would not stop at private tenancies, but re-examine the future of council houses and of mortgage interest relief. The latter concession spills over into consumer credit and raises interest rates generally. But only the Grand Inquisitor would use the lack of progress on these other fronts to hold up a measure which could bring unemployed people to places where jobs are to be found.

Private rented housing

Yes, minister, it can be freed

Can the market for private rented housing be revived? The housing minister, Mr Ian Gow, would like to revive it: he told the Conservative backbench environment committee last year that he planned to remove all new lettings from restrictions on rents, security of tenure, and so on, imposed by successive rent acts. About time, one might think, from a free-market government. It would be popular in parliament: a private member's bill last June attracted support not only from Conservatives but also from the two alliance parties.

The private market could do with a boost. When rent control was introduced in 1915, private lettings covered about 90% of all houses and flats. By 1950 this proportion had fallen to 45%. Today it stands at only 11%—and a third of that is military- and company-owned property, let free to tenants. Britain now has a much smaller private rented sector than any other developed country (see chart).

People in privately rented accommodation can move house quicker than owner-occupiers and council tenants. So the squeeze on private renting reduces labour mobility. An official study in Scotland, for example, reckoned that 48,000 fewer families there moved every year to take up new jobs than would have done if the bulk of rented accommodation had been in the private sector.

So what is stopping Mr Gow? When his civil servants looked at his plan, they pointed out that, because decontrol would raise rents, it would also mean the government having to pay more in housing benefits to poorer tenants. They told Mr Gow that the extra cost might be as much as £50m a year.

They were wrong. That calculation ignores several other effects of decontrolling rents. An alternative estimate would start with the fact that about 300,000 lettings are turned over every year. It might then assume that if these were decontrolled, their rents would rise by an average of £10 a week. The cost of housing benefits would indeed rise—by, say, 20% of the total rent increase, allowing for the likelihood that not everybody entitled to a rebate would claim it. The total cost to the government would therefore be £31.2m. But, against this, the treasury would get more taxes from landlords' higher incomes. Assuming an average tax take of 30%, the extra revenue would be £46.8m. So the treasury would scoop a net saving of £15.6m. Nor is that the end of the story:

- As tenancies end, many landlords are selling to owner-occupiers. If decontrolling rents were to encourage them not to, the government would save the tax relief on mortgage interest for the new owners.
- If the private rented market revived, the government would also save on non-income-related subsidies such as improvement grants. These average £150 for owner-occupied and council houses, only £30 a year for privately-rented housing—though that difference might vanish once landlords had reason to care.
- Improved labour mobility would probably reduce unemployment, saving the government unemployment pay and giving it more tax revenues.

Over to you, Mr Gow.

Source: Building Societies Association

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P.O. Box 7, 200 Gray's Inn Road, London WC1X 8EZ. Telephone: 01-837 1234

NO ROOMS TO LET

Today the House of Commons is asked to approve orders reducing the proportion of capital receipts which local housing authorities can recycle as improvement grants, repairs or new building. Much of the heat has gone out of the issue since Mr Gow announced concessions allowing councils to keep the proceeds of building houses for speedy sale. The 20 per cent proportion the Government is today asking for is too small – councils are being penalized for good housekeeping and enthusiastic pursuit of the Right to Buy policy. Yet it is only too small if capital receipts are being recycled to good purpose, and that must be defined as the maximum mobilization of private housing effort, especially for housing to rent.

The Government has been slow to apply its radical edge to the heart of Britain's housing problem. Peter Rachman, a name from the 1960s, still hangs over Conservative housing policy, a curse on all landlords and an excuse for inaction on the supply side of private accommodation for rent. What else but a 20-year old guilty conscience has prevented ministers – a Cabinet committed, at the least, to a rigorous examination of the welfare state – from thinking about dismantling the apparatus of rent control and tenancy restriction? Ministers say, diffidently, "no private company in its right mind would invest in building accommodation to rent" but in five years they do practically nothing. Now the housing lobbies, the bishops and the Royal Family rumble about an urban housing crisis; the homelessness figures rise and there are vivid case histories to match them. In response the Government is seemingly afraid to point to possible solutions in the private rented sector, to expound the role that landlords, small and large, might have in easing supply. At times the build-more-council-houses brigade is left in possession of the field while ministers entrench behind the strong (if unimaginatively built) walls of fiscal imperative.

The long and short of current housing policy is the extension of owner occupation. Here is an objective which matches a deeply-held popular ambition. Yet however stout, it cannot stand alone. The reality for the forseeable future is owner occupation for the many, public housing for a substantial minority, the two tenures buttressed each in its own way with subsidy (the great machine of housing benefit on one side, £3.5 billion worth of mortgage tax relief on the other) and restrictive practice.

This cannot be the full housing profile of a nation on the move, one responding to economic change, an occupationally mobile if less comfortable nation. A pool of rented housing is needed, easy to enter, easy to leave, housing of a type the private sector alone (a sector which includes charities, building societies and housing associations as well as rental firms and small landlords) can provide. To expand that pool by means both of de-regulation and financial incentives ought to be a government priority.

A programme to revive private rental housing in Britain starts at the centre with the Rents Acts, with fiscal discrimination against landlords and with Treasury rules about the way the Housing Corporation is prevented from levering building society and other private sector money into building for rent. At the heart of such a programme are the local authorities – some of which are shining examples of how, for example in the provision of rental accommodation for the elderly, private developers can be coaxed into innovative schemes. It is the local authorities which have sooner or later to accept that homelessness and under-provision can be met outside the ambit of the town halls and their authoritarian waiting lists and allocation points. Rachman remains an emotive word. But the real scandal of this decade will be if anachronistic attitudes delay or thwart private investment in our stock of housing for rent.

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