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cc NO

Treasury Chambers, Parliament Street, SW1P 3AG

D Barclay Esq
Private Secretary to the
Prime Minister
10 Downing Street
London
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1 March 1985

Dear David

HOME IMPROVEMENT POLICY

Andrew Allberry copied to me his letter of 11 February about private sector housing improvement policy. In advance of the Prime Minister's meeting on 6 March to consider the paper by the Secretaries of State for the Environment and Wales attached to his letter, the Chief Secretary thought it might be helpful to circulate the attached note which looks in more detail at the possibility of substituting loans for home improvement grants. The Chief Secretary would summarise the argument in the note as follows:

(i) It is not consistent with the Government's philosophy to assume that the State has a responsibility for the condition of the private sector housing stock, except in circumstances in which the condition of a dwelling represents a danger to public health

(ii) Loans are therefore preferable in principle to grants since they involve a lower subsidy (even after alllowing for costs of administration).

(iii) The proposed grant system would be targetted so as to give people sufficient to meet the cost of work, taking account of their ability to raise commercial loan finance.

(iv) It follows that, for a given level of subsidy, loans under the proposed scheme may be more attractive to owners than cash grants since the latter would not normally be sufficient to enable them to go ahead with the work.

I can confirm that the Treasury are content with the public expenditure calculations in the paper by the Secretaries of State.

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I am copying this letter to the Private Secretaries of members of H Committee and to Richard Hatfield at Cabinet Office.

Yours sincerely
Richard

RICHARD BROADBENT
Private Secretary

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HOME IMPROVEMENT: LOANS AS AN ALTERNATIVE TO GRANTS

Note by the Treasury

Underlying Philosophy

1. The Government's philosophy favours encouraging individual responsibility and choice, seeking market solutions to problems wherever possible. However paragraph 6 of Mr Allberry's letter of 11 February to Mr Barclay, covering the note by the Secretaries of State for the Environment and for Wales on home improvement policy, states that:-

> "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 of which successive Governments have based their policies."

It is undeniably the case that the private sector housing stock is a national asset; the majority of the population rely on it for their housing needs. However the Treasury has argued throughout the present discussions on improvement policy that it does not follow that the Government has a <u>responsibility</u> to ensure that the private sector stock is maintained.

2. In general, the condition of a particular dwelling is the responsibility of the owner, who alone bears the consequences of any failure to maintain his dwelling properly. Only where the condition of a dwelling deteriorates to such an extent that it imposes costs on other members of the community, for example by becoming a danger to public health, does the Government have a responsibility to ensure that action is taken. Where the owner has the means to carry out the necessary work unaided, no public funds are needed but if he does not, there is a case for assistance.

3. Indeed, in the absence of grants, provided owners are reasonably well informed and have access to suitable forms of finance, the market should operate so that prices reflect house conditions and enable improvement work to be carried out without assistance to the standard that owners desire. Where owners do not have the means to carry out such work, the dwelling will usually be improved on change of ownership. Any subsidy to improvement work is likely to be capitalised, to some extent, in house prices and frustrate the operate of the market because the increase in value of improvement work will need to be less than the cost of the work.

4. In practice, we have taken the proposed new minimum standard to be the one that should trigger Government concern. We have therefore supported the proposed new system of mandatory grants for dwellings falling below that standard provided they are means tested but opposed discretionary grants for dwellings above it.

Implications for Loans

5. This is the background to our attitude to substituting loans for grants. In particular:-

(a) We see no case for making loans available in addition to grants or on more generous terms since the proposed grant scheme is already wider than we would like;

(b) We would favour substituting loans for discretionary grants provided the additional administrative costs are not substantial since the subsidy involved will be lower than with grants;

(c) We also favour substituting loans for mandatory grnts since, wherethey are taken up, they will achieve the same effect at lower net present cost than grants. Where they are not, Minsiters may wish to consider whether, where there is a clear danger to public health, other powers should be available to local authorities to ensure that action is taken.

Terms of Loans

6. The note considers three possible terms on which loans might be given. In descending order of the subsidy involved these are:-

(i) interest free;
(ii) equity loan;
(iii) linked to an index of house prices.

In cases (ii) and (iii), it is assumed that interest is rolled up with the loan and paid when it is redeemed since loans will only be available to low income householders who cannot afford interest payments.

Subsidy Implicit in Loans

7. A proper measure of the subsidy involved is net grant equivalent ie the value of the loan less the repayments discounted at 5% real. Assuming a loan of £9,000 for 15 years (the average assumed in the DOE calculations) on works costing £10,000 with pre and post improvement values of £22,000 and £30,000 respectively (as noted in paragraph 4, so long as there is a subsidy system it may be the case that the cost of improvement is more than the increase in value), using the DOE's inflation assumptions, the net grant equivalents would, in each of the cases listed above, be:-

(i) £6,220
(ii) £4,997
(iii) £3,996

8. The calculations of (i) and (iii) are independent of the increase in value assumed whilst (ii) clearly depends on it and (for dwellings whose prices rise in line with house prices generally) can range between the extremes of (i) and (iii). Thus when the amount is given as grant it represents a subsidy of 90% of the cost, it represents one of 62% when given as an interest free loan, between 62% and 40% when given as an equity loan and 40% when given as a loan indexed to house prices. There will

be a degree of subsidy in these terms in any loan scheme with a real rate of interest of less than 5%.

9. These calculations are based on the assumed average length of time before the loan is paid off. In each individual case, the shorter the length of time, the lower the subsidy, and conversely. This is likely to reduce the extent to which the values of loans are capitalised in house prices. Moreover, if the loan scheme is properly targetted a loan is likely to be more effective than a grant of equivalent net present value. If the loan scheme is targetted so as to give just enough help to enable work to go ahead with the aid of savings and any commercial funding that can be obtained, the work would not be able to go ahead with a grant of equivalent value.

10. On the other hand a loan scheme is likely to reduce mobility because loans will become repayable when the recipient moves. The economic significant of this depends on how economically active are potential recipients; the available evidence suggests that they are relatively less active than owner occupiers as a whole. A further disadvantage is that a loan scheme is likely to be more costly to administer. There would be extra work in taking out a legal charge on the property and securing repayment many years after the loan was made.

Public Expenditure Aspects

11. In general we agree with the calculations of the public expenditure effects of loans as an alternative to grants. These are not significantly sensitive to the assumed rates of inflation and real increase in house prices. The important assumptions are the real rates of interest assumed and the proportion of loans repaid each year. The former will be determined by the terms of the scheme: the latter depends on how long recipients are expected to stay in their homes following receipts of loans.

12. We understand that, on the basis of the 1983 Distribution of Grant Enquiry, the DOE estimate that on average potential grant recipients will remain in the homes for 15 years following

receipt of grant. It is perhaps surprising that grant recipients expect to stay in their homes for such a long period, particularly since the average owner occupier stays only seven years and the 1981 English House Condition Survey found that a high proportion of potential recipients had lived in their present dwelling for 20 years or more. Nevertheless it is consistent with a picture of typical recipients living in one house for the greater part of their adult lives with low incomes and little spare cash for home maintenance.

13. Replacing grants by loans will tend to make recipients less mobile because it is proposed that loans should be repaid when the recipient moves. It is therefore likely that loan recipients will stay in their present home at least as long on average as the 15 years expected for grant recipients. The DOE have assumed an average repayment period of 15 years ie that one thirtieth (ie 3 1/3%) of the loans made in each year are repaid in each subsequent year.

Conclusion

14. Substituting loans for grants on the basis proposed is consistent with the Government's philosophy provided they are an alternative and not an addition to grants. Despite the relatively small public expenditure saving in early years they are likely to be more cost effective than grants for a given outlay.

Take up should only be of concern to the Government where there is a clear danger to public health. In such cases, local authorities could be given powers to ensure that owners took action, the cost being met by a loan where the owner was eligible.

15. However there are disadvantages. A loan scheme will tend to reduce mobility although, because potential recipients are likely to be disinclined to move for other reasons and to be among the less economically active, this should not have a significant effect. A loan scheme will also be more costly to administer. There is no reason to think that these extra

costs will outweigh the other public expenditure benefits of a loans scheme, but the practical problems need further study.

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