Chapter 6
Help with housing costs

The measures announced by the new UK government mark a shift in housing subsidies away from rental accommodation and towards the promotion of owner-occupation. The Help to Buy for London, Help to Buy Shared Ownership, Starter Homes and extension of right to buy are each intended to reverse the decline in owner-occupation. These schemes are analysed in depth in earlier chapters.

In this chapter we focus on two main issues: the changes in tax treatment of private rented accommodation, and the efforts of the government to contain the costs of housing benefit. Our regular assessment of the taxes paid and tax reliefs enjoyed by private owners appears at the end of the chapter in Table 2.6.4.

Tax treatment of private renting

In 2015 the relative tax treatment of residential property shifted firmly in favour of owner-occupiers, as the Chancellor announced changes in the tax treatment of rental properties.

This alters the previous balance of tax treatment between these categories of owner that had existed since the final abolition of owner-occupiers' mortgage interest relief in 2000. Since then, owner-occupied property has been treated as a consumer good and subject neither to the taxation of imputed rental income nor benefiting from tax relief on mortgage interest payments. In contrast, private landlords pay income tax on rental income, but are able to offset mortgage interest (and other allowable) costs against their rental (but not other) income. Obviously, this treatment favours long-standing owner-occupiers who have paid off their mortgage and therefore enjoy a significant net imputed rental income. A further significant tax advantage for owner-occupiers arises from their exemption from capital gains tax – which, net of roll-over relief, was worth £10.7 billion in 2014/15 (see Table 2.6.4 on page 101).

Since 2000, the context has changed. The decline in owner-occupation began before the financial crisis as potential buyers were priced out of the market. Since then, owners have been subject to additional product regulation. Following the Mortgage Market Review, the Financial Conduct Authority (which regulates individual firms and markets from a consumer perspective) introduced new criteria for assessing owner-occupiers' mortgages in April 2014. These include affordability and interest-rate stress tests based on a repayment mortgage. However, mortgages for private landlords are not subject to this regulatory regime, an anomaly that dates back to the introduction of the first statutory mortgage regulation in 2004. (By April 2016 the relatively small proportion of mortgages secured against buy to let (BTL) properties where the borrower has lived in the property or intends to do so will become subject to regulation under the EU Mortgage Credit Directive.[1])

The exclusion of BTL mortgages from regulation has led to interest-only mortgages being much more readily available to landlords than to would-be owner-occupiers. In the first quarter of 2015, more than 80 per cent of advances of non-regulated mortgages were interest-only, compared to less than ten per cent of regulated advances.[2] Clearly, this greatly increases the affordability of housing to landlords against would-be owner-occupiers, as Table 2.6.1 illustrates.

Table 2.6.1 **Costs of renting and buying in England in 2014 compared**

Median house prices and private rents – two-bedroom dwellings

Region	Prices	Mortgage costs		Rents	Mortgage costs as a % of rents	
		Interest-only	25-year repayment		Interest-only	25-year repayment
	£	£ per month	£ per month	£ per month	%	%
North East	97,000	252	470	450	56.0	104.5
North West	112,000	291	543	500	58.2	108.6
Yorkshire and The Humber	115,000	299	558	495	60.4	112.7
East Midlands	118,000	307	572	525	58.4	109.0
West Midlands	124,000	322	601	550	58.6	109.3
Eastern	175,000	455	849	650	70.0	130.6
London	330,000	858	1601	1450	59.2	110.4
South East	202,500	527	982	800	65.8	122.8
South West	160,000	416	776	625	66.6	124.2
England	175,000	455	849	595	76.5	142.6

Sources: 2014 House prices for two-bedroom dwellings from Regulated Mortgage Survey; private rents for year to December 2014 from Valuation Office Agency; average mortgage interest rates for new lending (3.12%) for 2014.
Note: To ensure a consistent comparison the England figures are calculated based on the numbers of two-bedroom dwellings in the overall private housing sector in each region.

Meanwhile the the Financial Policy Committee (FPC – which is charged with assessing systemic risks that may threaten the resilience of the financial system as a whole) has noted that the growth in mortgage lending was concentrated in the BTL sector, which it attributed 'largely... [to] the reduced availability of high loan to value (LTV) mortgage lending to owner-occupiers...'[3] Concerned that 'less stringent affordability tests than loans to owner-occupiers' might leave landlords more exposed to unexpected interest rate rises, the FPC supported a review of underwriting standards which is likely to result in the extension of the Powers of Direction that it gained over owner-occupier mortgages earlier in 2015 to the BTL sector. This would allow it to impose macro-prudential regulations on lenders' exposure to BTL, as well as owner-occupier, mortgages.[4]

These market and regulatory factors provide the context to the Chancellor's announcements. In the Summer Budget, he announced the phased restriction of mortgage interest tax relief for individual private landlords. From 2017/18 a higher or top-rate tax payer will be able to offset only 75 per cent of their interest costs against tax at their marginal tax rate. This will then be reduced by 25 per cent each year until interest relief can be deducted only at the basic rate of tax (see Table 2.6.2).

Table 2.6.2 **Restrictions of cost relief to individual private landlords**

	Maximum share of interest that can be deducted at marginal tax rate	Minimum share of interest that can only be deducted at basic rate	Saving to government: Restriction of tax relief (£ million)	Saving to government: Reform to wear and tear allowance (£ million)	Saving to government: SDLT surcharge on BTL and 2nd homes (£ million)
Current treatment	**100%**	**0%**	**n.a.**	**n.a.**	**n.a.**
2017/18	**75%**	**25%**	**0**	**205**	**625**
2018/19	**50%**	**50%**	**225**	**165**	**700**
2019/20	**25%**	**75%**	**415**	**165**	**760**
2020/21	**0%**	**100%**	**665**	**170**	**825**

Source: HMRC (2015) Restricting finance cost relief for individual landlords; HM Treasury (2015) Summer Budget Policy Decisions, Table 2.1; HM Treasury (2015) Spending Review and Autumn Statement Policy Costings, p.12.

The Chancellor gave two justifications for this policy.[5] His claim that the current tax arrangements give landlords 'a huge advantage in the market' is clearly open to dispute because, as we have seen, owner-occupiers are already treated more favourably, and this measure tilts the tax balance further in their favour. As we have demonstrated, the advantage that landlords have is in product availability which arises from regulatory imbalances. He also cited the Bank of England's concern about the role that BTL might play in destabilising the financial system. However, this concern relates to underwriting standards and the ability of landlords to withstand interest-rate rises. It is difficult to see how a measure that increases the chances of default tackles this problem. Interestingly, the government's impact assessment suggests that the measure 'is not expected to have a significant impact on either house prices or rent levels...'[6]

In addition to changes to wear-and-tear allowances, the Chancellor announced that individual private landlords, and people buying second homes, would be subject to an additional three percentage point rate of stamp duty land tax (SDLT) from April 2016.[7] Since SDLT is devolved in Scotland, this measure applies only to England, Wales and Northern Ireland. However, the Scottish Government has chosen to add the three per cent surcharge to the Scottish rates of its land and buildings transaction tax.

Table 2.6.3 **Stamp duty land tax rates from April 2016 (England, Wales, Northern Ireland)**

Property value band	Owner-occupied	Individual landlord
£0-125,000	**0%**	**3% (over £40,000)**
The proportion from £125,001-250,000	**2%**	**5%**
The proportion from £250,001-925,000	**5%**	**8%**
The proportion from £925,001-1.5 million	**10%**	**13%**
The proportion over £1.5 million	**12%**	**15%**

Source: HMRC (2015) Higher rates of Stamp Duty Land Tax (SDLT) on purchases of additional residential properties.

The Chancellor's justification for this policy is also purely pragmatic. In his Autumn Statement and Spending Review speech he stated, 'Frankly, people buying a home to let should not be squeezing out families who can't afford a home to buy.'[8] He noted that cash purchasers will not be affected by the cuts to landlords' mortgage interest tax relief, whereas even non-UK residents would have to pay SDLT. It is notable that this reform is expected to raise more revenue than the reduction in tax relief. A token £60 million of the revenue raised from this measure has been promised to parts of England where the impact of second homes is 'acute'.[9]

This policy marks a return to the use of the housing transactions tax to micro-manage the housing market. A stamp duty 'holiday' was employed in the early 1990s in an attempt to stimulate the market. Thereafter, under the New Labour government a bewildering array of rates and exemptions were introduced to tackle a variety of housing market issues ranging from reviving housing markets in disadvantaged areas to concessions designed 'to help kick-start the market for zero-carbon homes, encourage micro-generation technologies, and raise public awareness of the benefits of living in zero-carbon homes'.[10]

The adoption of a 'slice' structure in 2015 was a clear improvement on the 'slab' structure it replaced, but compared to the period up to 1997 when a single one per cent rate was applied on the entire value of properties over a threshold, the system of taxing housing transactions has become much more complex. It is also a rich source of revenue. In 2014/15 the tax raised £7.1 billion in England alone – surpassing the pre-recession peak (see Compendium Table 106).

Interestingly, the government intends to exempt corporate entities or funds that make a significant investment in residential property. This has been justified 'given the role of this investment in supporting the government's housing agenda'.[11] Housing associations that supply market rental housing are likely beneficiaries of this concession which the government intends (subject to consultation) to apply to owners of 15 or more properties.

Private landlords are unlikely to receive very much public sympathy regarding these tax changes, particularly in the light of cuts to housing benefit highlighted below and analysed in detail in Contemporary Issues Chapter 2. However, it is concerning that the UK is returning to the unbalanced support for homeownership that has contributed to persistent market volatility.[12] The anomaly arising from the populist measure to scrap the tax on owner-occupiers' imputed rental income in 1963 (announced the previous year in an unsuccessful attempt to avert a by-election loss) took almost four decades to reverse. It is our preference that a level playing field be achieved between owning and renting by correcting anomalies where they occur, not by introducing new ones elsewhere in the system. The advantage enjoyed by BTL landlords in the mortgage market and any threat lending to them brings to financial stability would be best tackled by extending the regulatory micro- and macro-prudential regimes operated by the FCA and FPC. Given the disruptive role that the housing market has played in the economy over at least the past three decades, there is a case for an overall assessment of the different types of risks arising from the housing sector, and co-ordination of the responses to them. The current fragmented approach may itself become a source of regulatory failure.

As it stands, the Chancellor's SDLT surcharge risks provoking the kind of disruption in the housing market that occurred when the government gave advanced warning of the withdrawal of 'multiple' mortgage interest relief in 1988. Nigel Lawson (the then Chancellor) recalled, 'What this... did was to add froth to an already heady housing boom, which made the subsequent inevitable downturn all the more painful… [W]hat was wrong was the long delay between the announcement and implementation.'[13] However, the temptation to bring forward purchases may well be offset by the impact of reductions in interest tax relief: a poll found that more than one quarter of landlords intend to slow down or stop acquisitions, or reduce or sell off their portfolios.[14]

Housing benefit

Housing benefit in its current form has been in existence for more than a quarter of a century. The latest round of restrictions to the benefit are analysed in detail in Contemporary Issues Chapter 2. Here the rationale behind the design of the benefit is outlined, and trends in expenditure examined.

Housing benefit's simple 'single taper' structure was broadly welcomed at the time of its introduction, as previous systems had been complex and subject to anomalies. The principle that underpinned the system introduced in 1988 was that incomes after rent should not fall below the amounts allowed for non-housing living in baseline means-tested benefits such as income support. This was necessitated because such benefits (including job seeker's allowance today) make no allowance for housing costs. It explains some features of the system, namely that housing benefit can meet the whole of a tenant's rent, and that if a rent rises by £1, HB rises by the same amount (and vice versa). This makes the British system appear generous compared to housing allowance systems operated in some continental European and Scandinavian countries. However, these countries' mainstream social security benefits do make an allowance for housing costs, so it is reasonable for tenants to be expected to make a contribution towards their rent. Moreover, it is common for additional assistance for housing costs to be provided through social assistance benefits. Such assistance may include meeting the entire cost of the rent.

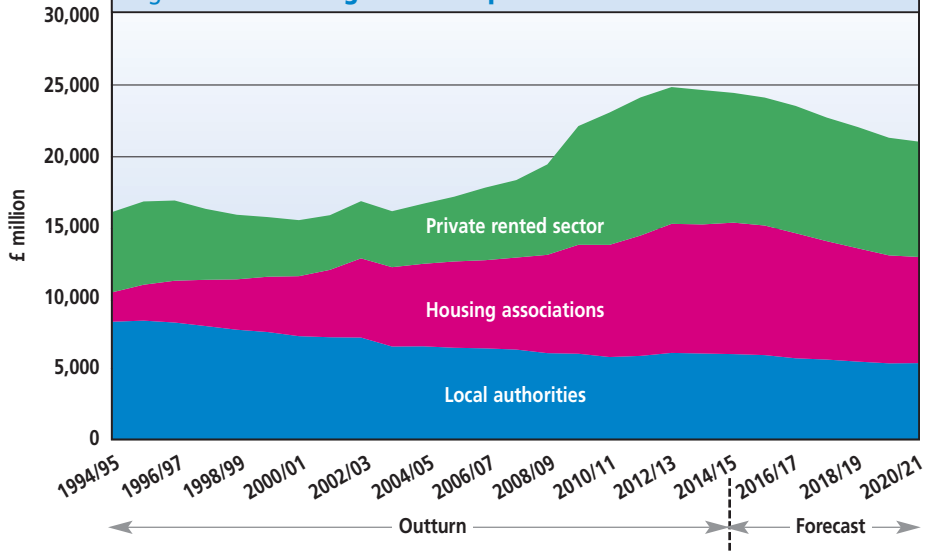
Nonetheless, the British system has always been open to concerns that it contributes to rent inflation and provides tenants with little incentive to economise. To some extent this is what the system was expected to do. It was introduced at the same time that housing associations were expected to raise rents as they became less dependent on government grants and to raise much higher proportions of their development finance from the market. It was also introduced at the same time that new private rental tenancies were deregulated. Letting housing benefit 'take the strain' became the stock response to concerns about rising rent levels on affordability and was central to the expansion of the housing associations' private finance market that grew from 1988 onwards.

It is unsurprising, therefore, that the costs of housing benefit have risen (see Figure 2.6.1). The real cost of HB rose from £16.1 billion in 1994/95 to a peak of £24.9 billion in 2012/13. The overall increase in cost of 55 per cent masks great variation between tenures. The real cost of HB for local authority tenants *fell* by 55 per cent, whilst that for housing association tenants rose more than three-fold (338 per cent), reflecting the decline in the number of local authority homes, mainly due to stock transfers to HAs. Overall, the real cost of HB for all social tenants rose by 46.5 per cent to 2012/13. It might be noted that the effect of the RPI+1% formula for increasing rents in England for more than a decade placed an upward pressure on costs before the introduction of Affordable Rents.

The cost of HB for private tenants rose by more than half (55 per cent) over the same period. However, the change in cost in the private rented sector is complicated, as it fell for seven of the nine years after 1994/95. This reflected buoyant employment levels among tenants and the effect of the restrictions introduced on eligible rents. The cost of HB for private tenants therefore fell by 30 per cent from 1994/95 to 2003/04, and then rose rapidly especially as the recession took hold in 2008/09-2010/11. So HB costs for private tenants were 1.5 times higher in the peak year of 2012/13 than in 2003/04.

The composition of the HB bill remained remarkably stable, if we set aside the change in composition within the social rented sector. In 1994/95, 65 per cent of HB expenditure was attributable to social tenancies and 35 per cent to private ones. In 2012/13, social tenancies still accounted for 62 per cent of the cost, while private ones accounted for 39 per cent (these are rounded figures).

Figure 2.6.1 **Housing benefit expenditure in real terms 1994-2021**

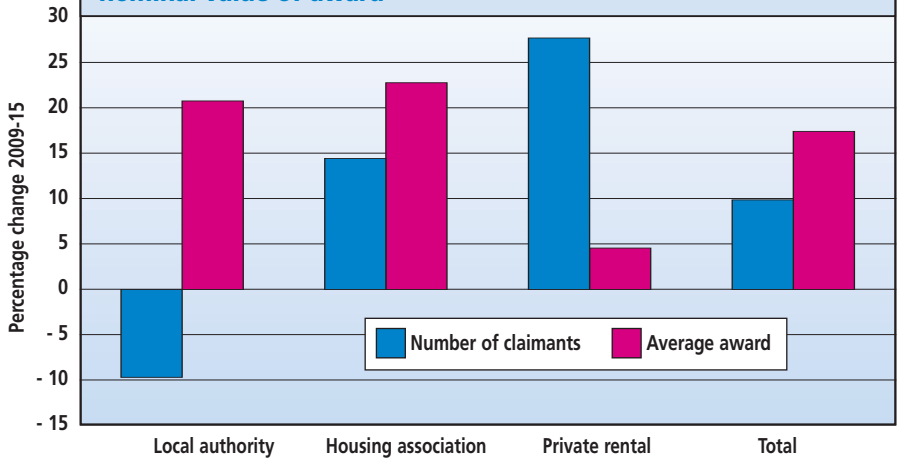


Source: Compendium Table 112 and earlier versions (previously Table 114).

Since 2010 the measures adopted by the government have combined with economic recovery to reverse the rise in HB expenditure. There has been a fall of 1.7 per cent in real terms since it peaked in 2012/13 – amounting to under £500 million by 2014/15. Expenditure continued to rise among HA tenancies, but fell by 5.4 per cent among private ones. By the end of the forecast period (2020/21) HB expenditure is expected to be almost £3.9 billion below peak – a fall of 15 per cent overall. The proportionate reduction in spending on social tenancies is expected to be almost the same as on private ones. This reflects the gradual extension of restrictions on eligible rent to the social sector, as well as planned reductions in social rents introduced in the Summer Budget.

Figure 2.6.2 shows how the cash costs of HB have been driven since 2009 by the combination of changing numbers of claimants and the average value of awards. Overall the number of claimants rose by ten per cent over this six-year period, and the average value of claim by 17 per cent. Overall the number of social tenant claims remained almost static, due to rising numbers of HA claims being counterbalanced by falling numbers of local authority ones. In contrast, the number of private rental claims rose by 28 per cent. However, average awards for social tenants rose by more than one-fifth, whilst average awards for private tenants rose by less than five per cent.

Figure 2.6.2 **Percentage change in numbers of claimants and nominal value of award**



Source: Calculated from Compendium Table 111.

The restrictions to HB, which began with the introduction of the single room rent (now shared accommodation rate) in the mid-1990s, but intensified after 2010 and 2015, have been introduced to control expenditure. However, they also undermine the basic principle of protecting after-rent incomes. For people of working age these are very low, for example in 2015/16 the rates of social assistance benefit are typically £57.90 per week for a single person aged under 25, £73.10 for a single person aged 25 or over, and £114.85 for a couple (both aged over 18). Limitations to housing benefit have now moved from those primarily intended to prevent abuse of the system, to ones that more routinely expect tenants to contribute to the cost of rent out of already meagre incomes.

Private owner taxes and tax reliefs

Table 2.6.4 makes a regular appearance in this chapter of the *Review* and shows how the balance between taxes and tax reliefs has changed over a 20 year period. Throughout the period private owners as a whole have been net beneficiaries of the tax system as it relates to property. Over time the burden of property-related tax has shifted from inheritance to stamp duty. Twenty years ago almost half of the gross tax was accounted for by stamp duty and half by inheritance tax. Now stamp duty accounts for 85 per cent of the total. The pattern reflects the economic – and most especially the housing market – cycle as stamp duty is an unstable revenue, housing transactions being even more volatile than prices. So, although revenue from inheritance tax also falls during a recession, stamp duty still accounted for almost three-quarters of housing taxes in 2008/09. Revenue from stamp duty now exceeds its pre-recession peak, and inheritance tax may do soon.

The composition of tax reliefs for private owners has also changed over the past two decades. The very small scale of net capital gains tax relief (just 4.2 per cent of the total) in the mid-1990s reflected the depressed level of proceeds following the housing market recession. Now the split is roughly 55/45 in favour of imputed rental income. In 2009/10, during the recent recession, the balance was roughly 80/20 in favour of imputed rental income. The value of net capital gains tax relief is now at a record level (in cash terms).

The table serves as an instructive reminder that, at national level, the value of the net tax reliefs to private housing is equivalent to about 60 per cent of the housing benefit bill.

Table 2.6.4 **Private owner taxes and tax reliefs**

£ million

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Taxes																				
Inheritance tax	429	440	480	496	611	684	769	870	999	1,166	1,300	1,409	1,490	1,057	918	1,072	983	1,089	1,182	1,323
Stamp duty	465	675	830	1,065	1,825	2,145	2,690	3,525	3,710	4,620	4,585	6,375	6,680	2,950	3,290	4,040	4,220	4,905	6,450	7,500
Gross Tax	894	1,115	1,310	1,561	2,436	2,829	3,459	4,395	4,709	5,786	5,885	7,784	8,170	4,007	4,208	5,112	5,203	5,994	7,632	8,823
Tax Reliefs																				
Imputed rental return tax relief (net)	- 7,600	- 8,300	- 7,400	- 9,800	- 12,800	- 14,100	- 14,800	- 16,900	- 17,300	- 14,600	- 15,000	- 14,200	- 11,900	- 8,600	- 9,100	- 11,700	- 13,100	- 12,100	- 13,700	- 13,600
Capital gains tax relief (gross)	- 500	- 600	- 800	- 1,400	- 3,000	- 3,300	- 6,000	- 10,000	- 10,500	- 13,000	- 12,500	- 15,800	- 14,500	- 4,900	- 3,700	- 8,800	- 10,400	- 10,500	- 13,000	- 16,300
Capital gains tax relief (net)	- 330	- 396	- 528	- 601	- 1,287	- 1,416	- 2,574	- 4,290	- 4,505	- 5,577	- 5,363	- 6,778	- 6,221	- 3,234	- 2,442	- 5,808	- 6,864	- 6,930	- 8,580	- 10,758
Total Net Tax Reliefs	- 7,930	- 8,696	- 7,928	- 10,401	- 14,087	- 15,516	- 17,374	- 21,190	- 21,805	- 20,177	- 20,363	- 20,978	- 18,121	- 11,834	- 11,542	- 17,508	- 19,964	- 19,030	- 22,280	- 24,358
Net tax position	- 7,036	- 7,581	- 6,618	- 8,840	- 11,651	- 12,687	- 13,915	- 16,795	- 17,096	- 14,391	- 14,478	- 13,194	- 9,951	- 7,827	- 7,334	- 12,396	- 14,761	- 13,036	- 14,648	- 15,535

Sources: Inland Revenue Statistics (various years), HM Revenue and Customs Statistics (various years).

Notes: Estimates of capital gains tax relief are based on two-thirds of HMRC estimates to provide for roll-over relief. A further 35% deduction has been applied for the years from 1998/99 to 2007/08 to allow for the CGT taper relief that applied in those years. It should also be noted that the stamp duty and inheritance tax yields are for all residential dwellings, and not just those occupied by homeowners. The imputed rental return tax relief is based on the asset values and mortgage debt figures from Table 45, average mortgage interest rates, net residential yield figures from the IPD Index and standard rates of income tax.

References

1 HM Treasury (2015) *Implementation of the EU Mortgage Credit Directive* (updated 26 January). London: HM Treasury.

2 Bank of England Prudential Regulation Authority, Mortgage Lenders and Administrators (MLAR) Statistics, Table 1.32, 9 June 2015.

3 FPC Meetings 25 and 30 November 2015 (see www.bankofengland.co.uk/financialstability/Pages/fpc/meetings/default.aspx).

4 HM Treasury (2015) *Financial Policy Committee powers of direction in the buy-to-let market*, 17 December. London: HM Treasury.

5 HM Treasury (2015) *The Chancellor's Summer Budget Speech 2015*. London: HM Treasury.

6 HM Treasury (2015) *Higher rates of Stamp Duty Land Tax (SDLT) on purchases of additional residential properties*, 28 December. London: HM Treasury.

7 HM Revenue & Customs (2015) *Restricting finance cost relief for individual landlords* (Policy Paper, 8 July). London: HMRC.

8 HM Treasury (2015) *The Chancellor's Summer Budget Speech 2015*. London: HM Treasury.

9 HMRC (2015) *Main tax announcements for Autumn Statement 2015* (see www.gov.uk/government/publications/main-tax-announcements-for-autumn-statement-2015/main-tax-announcements-for-autumn-statement-2015).

10 HM Treasury/HMRC (2007) *Budget 2007: Regulatory Impact Assessments*, para. 9.1. London: HM Treasury.

11. HM Treasury (2015) *Spending Review and Autumn Statement 2015*, Cm 9162, p.121. London: HM Treasury.

12 Stephens, M. (2011) *Tackling housing market volatility in the UK: Report of the Joseph Rowntree Foundation Housing Market Taskforce*. York: JRF.

13 Nigel Lawson (1992) *The View from No. 11: memoirs of a Tory radical*, p.820. London: Bantam Press.

14 YouGov (2016) Survey of Landlords, 6 January (see www.cml.org.uk/news/news-and-views/buy-to-let-a-happy-new-year-for-landlords/).