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Report 17

Disrepair in owner occupation in Scotland: a review of policy options in reserved areas

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Working for housing and regeneration

Disrepair in Owner Occupation in Scotland: a review of policy options in reserved areas

by

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A Report to Communities Scotland

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Introduction

The aim of this report is to identify and explore policy options aimed at improving the state of disrepair in the Scottish owner occupation sector with a particular focus on possible policy options in areas reserved to the Westminster Parliament, that is tax, benefits and financial regulation.

While most owners are clearly able and willing to maintain their properties to a state of satisfactory repair, a significant number appear to struggle in this, being either unable or unwilling to manage and resource the effective maintenance of their homes.

The report builds on a substantial body of work already commissioned by Communities Scotland and the Housing Improvement Task Force, particularly "The Future of Owner Occupation in Scotland: Issues of Sustainability"[1] and "Issues in Improving Quality in Private Houses".[2] While seeking to focus on reserved powers and minimise repetition of work already carried out, the report also seeks to identify emerging views and developing trends on a wider UK basis.

[1] "The Future of Owner Occupation in Scotland: Issues of Sustainability" Glen Bramley, Janet Ford, Tania Ford, James Morgan and Steve Wilcox Communities Scotland November 2001

[2] "Issues in Improving Quality in Private Houses – The first report of the Housing Improvement Task Force" Housing Improvement Task Force August 2001

1 Overview and context

The condition of owner-occupied properties in Scotland is generally better than those elsewhere in the UK. Despite this "The First Report of the Housing Improvement Taskforce"[3] concludes:

- A significant minority of owner-occupied houses in Scotland suffer from some level of critical disrepair resulting from the neglect (for whatever reason) of basic maintenance and repair activity.
- A significant number of owners still live in homes that fail the tolerable standard or do not meet what would be regarded as a modern standard.
- A significant number of homes (perhaps 5% of the stock) may well be in disrepair over the long term.

Public policy and good governance experience a tension between the libertarian perspective that an individual owner should be free to decide the condition and quality of the asset in which they live, and the longer-term public benefits that flow from owners collectively maintaining the nation's housing assets in good and healthy condition.

At one level it has long been accepted that "the argument that owners are entitled to neglect their property to the detriment of their community was settled in the 19th century. They are not".[4] At another level there has been a long tradition of encouraging owners through tax incentives and grant assistance to improve and maintain their homes. Similarly there is increasing awareness of the impact which poor housing can have on health and education. The declining level of resources committed to encouraging responsible home ownership, coupled with a re-emergence of the importance of disrepair across all tenures has prompted considerable academic and political comment and debate in recent years.

The reasons owners fail to maintain their properties to an optimum standard can be summarised as:

- personal choice
- lack of awareness
- lack of incentive
- lack of funding
- inability (real or self perceived) to manage the maintenance process.

In practice a combination of these reasons is often likely to apply.

At the broadest level the tools available to government to encourage owners to maintain and improve their properties range from:

- removing disincentives and barriers

[3] "Issues in Improving Quality in Private Houses – The first report of the Housing Improvement Task Force" Housing Improvement Task Force August 2001

[4] Don Simpson. Quotation from interview.

- advocacy
- providing incentives
- providing support
- regulatory intervention
- legal obligations and requirements.

There has been near unanimity of commentators identifying some taxation practices – notably VAT on repairs and improvements – as providing a disincentive to property maintenance. At the other extreme very few have been so interventionist as to suggest:

"The state could intervene more extensively in the market by compelling owners to maintain their homes in good condition and taking powers to intervene and charge the costs against the property if they did not do so"[5]

Direct compulsion against owners is a sanction that only appears to command acceptance when others are at risk. A neat conceptual line is drawn by the widespread acceptance that it is quite proper for the Health and Safety Executive to insist – on pain of prosecution – that landlords obtain an annual gas appliance check on their properties, but that no such intrusion is envisaged for owner occupiers.

Disrepair policy can be observed to operate at two levels, national and "local" or "targeted". At the national level policy (favourable or adverse) impacts on most or all owners. It is at this level that long term strategic consideration should apply to encourage and ensure that the great majority of properties which are in good condition remain that way, and ensure that owners of properties which fall into disrepair are persuaded and able to repair them from their own resources.

At the more focused local or targeted level, policy will be directed to a specific locality or client group where disrepair problems are clearly visible. Local or targeted policy is likely to require additional and more concentrated resources, and implies a higher degree of proactive and interventionist measures than may be appropriate at the national level.

The remainder of this paper will consider firstly identified disincentives and barriers that apply at the national level, and then review suggestions and wider European experience for approaches which provide "whole stock" incentives to owners to maintain their homes. Closer consideration will then be given to understanding attitudinal and lifestyle issues relating to owner occupiers and property repairs, and considering why some owners do not invest appropriately in repair work.

The paper will then consider incentives and barriers that apply at the more focused and interventionist level. For example there are many good examples of "Care and Repair" and "Home Improvement" agencies working with councils and local communities or older owners to provide support and to broker repairs and improvements. However there are a surprising number of – well-intentioned – regulatory barriers hindering the work of the agencies.

Finally some suggestions will be made for linking a number of approaches to facilitate and stimulate a more systematic approach to home maintenance.

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[5] "Crumbling Castles? – Helping owners repair and maintain their homes" p49 Philip Leather JRF March 2000

2 Identified "national" disincentives and barriers that apply "across the stock"

The two most cited disincentives are the high rate of Value Added Tax (VAT), and the lack of value imparted by an owner improving their property. Taxation of income generated from the investment of sinking funds is also a sensitive issue.

Value Added Tax

VAT is currently charged at 17.5% on almost all repairs and improvements to property. This provides an incongruous situation where the owner of an existing property needing for example a new roof and other works costing £10,000 is faced with an additional £1,750 tax bill. In contrast new property is zero rated for VAT purposes.

Almost all of the commentators interviewed or reviewed shared the view that VAT had an adverse impact on property condition. Typically the Council for Mortgage Lenders state

"The current 17.5% rate is a disincentive to refurbishment and encourages people who do not wish to incur or cannot afford further cost to use "cowboy" builders. Reducing or removing VAT on home improvement could significantly encourage investment in the existing housing stock."[6]

This message appears to have been heard in part by the Treasury, with a number of useful exceptions being recently introduced. These include:

- a reduction of VAT from 17.5% to 5% for the conversion of residential dwellings into a different number of dwellings
- a reduction of VAT to 5% on refurbishment costs of properties that have been empty for over three years
- a zero rate of VAT on refurbishment costs of properties that have been empty for over ten years
- a zero rate of VAT for adaptations relating to disability and facilitating mobility
- a reduction of VAT to 5% on installation of energy saving material in domestic property when installed by an approved contractor
- a reduction of VAT to 5% on installation of central heating and linked security works when funded by Government grant (such as HEES-Home Energy Efficiency Scheme).

[6] "Policy Response: Comprehensive Spending Review" Council of Mortgage Lenders October 2001

While there is general agreement on the negative impact of VAT on maintenance of owner-occupied properties, no substantive work appears to have been carried out to model the financial implications of a reduction in VAT in terms of reduced tax take, nor in terms of increased work undertaken and impact on property condition.

It is very unlikely that the Treasury would support a blanket reduction in VAT on home maintenance and improvements unless matching funds or benefits could be clearly identified elsewhere. While some compensating gain could be anticipated from a reduction in use of unregistered contractors, and an increase in work commissioned it is unlikely this would approach the tax lost.

However it may be that a case could be made for VAT reduction as part of a scheme which focused solely on essential maintenance and repairs. This would be in line with the gradual reduction of VAT on the types of work to residential property already identified, and could borrow the same "public policy" justifications.

Taxation of investment income of sinking funds (and service charge funds)

The first report of the Housing Improvement Task Force identifies the provision of a sinking fund as a feature of some of the more modern and better-managed communal developments. It is considered good practice amongst housing associations providing low cost home ownership properties and retirement properties to provide a sinking fund to provide for future major repairs.

One feature of sinking funds is that when the funds received are invested their yield is subject to taxation. In most circumstances the rate of taxation is 34%, the Inland Revenue holding that the money is held "on trust" and that it should therefore be taxed at a rate of 34%, being the rate of Corporation tax applicable to Trusts.

This issue has recently been raised in the UK Parliament, and elicited the following ministerial response (extract only shown):

> "However, there is no rationale for exempting that type of income from tax or for taxing it purely at the lower rate. If the funds were held by individuals in a bank or building society account, the interest arising on that investment would be taxed in the normal way. The fact that funds are held in trust is no reason to exclude them from tax."
>
> "The rate at which trustees pay tax on income is set to take into account the wide variety of circumstances of those who put funds into the trust or who otherwise benefit from the trust… Those funds are not just for poor tenants. They can be found across all types of housing."
>
> "…the 34 per cent. Rate…is charged on the trustee, not the person who pays money into the trust or the beneficiary. It is set at a rate that takes into account the fact that beneficiaries of the trust may pay tax at the basic or higher rates, and that others might even be non-taxpayers. The rate is set at a level that minimises the opportunities for trusts to be used to avoid tax, because that cannot be right."

Ruth Kelly MP. Financial Secretary, Hansard 3 July 2002 col 359.

It does however appear both a disincentive to good practice, and inequitable on lower income owners, for sinking fund investment income to be taxed at such a high rate. All taxpayers have the opportunity to preserve their savings from tax through investment in ISAs, and only a small minority of taxpayers use their full ISA entitlement every year. While accepting the need to avoid abuse of Trust legislation for tax avoidance by the wealthy, the current rules would appear to both act as a clear penalty on responsible provisioning for repairs, and to be regressive against the incomes of householders most likely to be contributing. It should not be difficult to amend the 1998 Finance Act in a way which provides against abuse, but allows a certain level of investment per year to receive equivalent taxation status to investment in, say, an ISA.

Market distortions

It is a peculiar feature of the British housing market that in almost all locations the value of a property – as defined by what individuals are willing to pay for it – is not proportionately enhanced by repair and maintenance expenditure.

While adding new features to a property, particularly central heating, *may* generate a pound for pound increase in value against expenditure, investment in essential maintenance would typically raise the value by less than 50% of the expenditure.

There are a number of interlocking reasons for this. Except in cases of extreme disrepair or structural failure, mortgage lenders currently appear to have a very benign approach to lending on properties in poor condition. Provided the property has been independently valued in its current condition, mortgage lenders will lend up to the value, subject to the borrowing power of the purchaser.

Purchasers in turn appear to judge the value of property relative to others, and with regard to locality, amenity, size, appearance and facilities, and with a relatively low weighting given to the state of repair. The value of occupancy and affordability of monthly outgoings can leave purchasers willing to borrow to pay up to the amount lenders are willing to lend. In the process disrepair may be noted, but is only marginally related to purchase price, and hence value, on a pound for pound basis.

To an extent these market distortions are likely to be partly an effect of the taxation system, partly the effect of the regulatory system, and partly a consequence of personal choice. There appears no direct “relaxation” that could be applied by Government to address this market distortion, but different approaches to national taxation and regulation could significantly redress the distortions identified, as considered in subsequent chapters.

3 Wider "Whole Stock" incentives and possible reforms relating to taxation and regulation

Taxation

Different European countries have significantly different approaches to property taxation, many of which build in clear incentives to invest in repair, maintenance and improvement. Three particularly relevant publications considering different aspects of European property taxation as applied to owner occupiers are identified as:

"A Study of European Land Tax Systems. Second Year Report"[7]
"Financing Homeowners' Repairs – Learning from Europe"[8]
and "RICS European Housing Review 2002"[9]

It is from these publications plus interviewees' observations that the following section is mainly drawn.

The taxes which impact on owner-occupied properties in Britain are:

Stamp duty: This is payable on conveyancing property according to sale price at the following rates:

Up to £60,000	Nil
Over £60,000-£250,000	1% of sale price
Over £250,00 to £500,000	3% of sale price
Over £500,000	4% of sale price

These rates have been increased steadily from a 1% flat rate in 1997.

From 30 November 2001 exemptions to stamp duty were made for purchased up to £150,000 in designated disadvantaged areas.[10]

Council Tax: This is set locally and is banded according to property value.

VAT: Value Added Tax is charged on repairs, maintenance and improvements to existing buildings at 17.5%. A range of reductions have been introduced in recent years relating to certain energy saving and heating initiatives, and on longer term empty properties, as detailed above. New buildings are zero rated for VAT.

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[7] "A Study of European Land Tax Systems. Second Year Report" Professor P K Brown M A Hepworth 2001 David C Lincoln Fellowship Year 2 report

[8] "Financing Homeowners' Repairs – Learning from Europe" Michael Oxley, Andrew Golland, Sarah Hodgkinson and Angela Maye Joseph Rowntree Foundation/YPS 1999

[9] "RICS European Housing Review 2002" Michael Ball RICS 2002

[10] "Stamp duty exemption for disadvantaged areas" Inland Revenue at www.inlandrevenue.gov.uk/rates/stamprates.htm November 2001

Other taxes: Unlike other European countries owner-occupied dwellings are exempt from UK capital gains tax and income tax, and the UK has no wealth tax. Properties are subject to gift and inheritance tax (other than between spouses) as part of the total estate value, with the estate (not recipient) normally being liable for any tax.

Reliefs: Unlike other European countries there are no tax reliefs on the costs of owner occupation. Income Tax relief on interest payments was phased out during the 1990s, and income tax on the imputed rental value of a property was abolished in 1963. Up until 1963 British owner occupiers were taxed on the "imputed" rent they saved from living in their property (and could have charged a tenant), against which they could offset mortgage interest and maintenance and repair costs.

Many European countries apply a wider range of both property taxes and reliefs than apply in the UK. These are summarised in the following table with an indication of the range of tax applied.

Tax	UK	Europe	Reliefs (Europe)
Stamp duty, transfer tax etc	Yes	Most countries charge some combination of stamp duty, registration duty and transfer tax, sometimes all three. Very wide range of charges 1% to >15% NB VAT may be added for new properties.	Social policy, recent purchase.
Inheritance tax	Only as part of value of estate, and normally paid by estate of deceased	Almost universal, normally paid by recipient, and banded by value/income. Upper bands typically range from 25% to 50%	Outstanding liabilities
Capital gains tax	No	Common. In some countries capital gains on disposal are paid by an explicit capital gains tax, in other countries through income tax.	Indexation (inflation), extensions, major repairs, refurbishment etc.
VAT on new building	Zero	Charged in approx 50% of countries. Typically between 10%-20%	7 EU countries allow social policy reductions for supply, construction, alteration, renovation[11], including France and Italy
Vat on repair and maintenance	Normally 17.5%	Charged in most countries. Typically between 15%-25%	
Property tax	Council tax	Fairly universal. Over 190 different variations. Normally based on valuation or floor area.	Complex, but no repair reliefs identified
Income tax	Not since 1963	Not generally, but in Belgium an imputed income Revenue Cadastral is charged on owner occupancy (in a comparable way to company car tax in the UK). A similar system exists in Sweden and Switzerland.	Mortgage interest and repair costs are often allowed as a relief, even when ownership is not charged against income tax.
Wealth tax	None	7 countries apply an annual tax in range 0.35%-5.25% pa (normally <1.2%)	

[11] "Study on the application of Value Added Tax to the property sector" Executive summary and Country Overviews Arthur Anderson N XX1/96/CB-3021 (for European Commission)

The above summary is useful in that it identifies the range of tax policies and taxation levels which are acceptable within democratic countries, and by implication maps out the potential scope for change within the UK. Points that may be derived from observation of a summary at this level include:

- transaction taxes are often far higher in European countries than the UK
- similarly VAT is charged – and at quite a high level – on new properties in many European countries
- likewise a number of countries charge owners tax on the capital gains made on sale.

The above three points imply the potential for a higher level of tax take on new construction and property transactions. It is particularly noticeable that the recent significant increases in UK stamp duty on house sales has had minimal apparent impact on house prices or labour mobility, and appears to have been achieved without excess protest or expressions of discontent.

These points imply that it is a viable option to raise certain property taxes, either to "rebalance" the market, or more popularly, to fund tax reductions on maintenance, and potentially allow relief on owners' repair costs.

A significant number of countries allow owners to claim tax relief on repair and maintenance expenditure, and/or refurbishments and improvements. The data available did not allow the full extent of this practice to be identified, but it generally seems to apply in countries where capital gains were taxed, and was clearly identified in a number of other countries where relief was allowed against income tax.

Brown and Hepworth observe (concerning relief for repairs expenditure) "From a taxpayer's perspective, the taxation of such gains as part of income tax may be beneficial as expenses incurred in maintaining the assets may often be set off against other income as they are incurred. On a capital gains tax system the expenses can often only be set against tax as and when the property is sold."[12]

In many European countries home ownership is taxed much more heavily than in the UK. Despite this, home ownership is generally an increasingly popular tenure in almost all European countries.

An implication is that in most European countries property is seen less as an investment, and more as a place to live. It can be inferred (though not proven) that the different taxation regimes may remove some of the imbalance between cost of outstanding repair work and value.

It should also be noted that:

> "No individual tax can be seen as a totally stand-alone tax and the reform of one tax will often have consequential effects on others"[13]

However the range and type of tax chargeable in other European countries indicates clear scope for refocusing property taxes in the UK to include an incentive for owners to maintain their homes.

[12] "A Study of European Land Tax Systems. Second Year Report" para 8.3

[13] Ibid page 23

Additionally no study appears to exist which has examined in depth the link between property taxation and stock condition on a European basis.

However it is possible to gain some useful insights into potentially beneficial changes by considering taxation practice in individual countries, where adequate information is available.

Belgium (and also Sweden and Switzerland) has a system of charging owners income tax on an imputed income from their property, and then allowing the owner to claim relief against this imputed income for maintenance and mortgage payments. It is possible to make a degree of linkage between recent refurbishment of older properties in Belgium being brought into owner occupation from the rented sector, and the tax incentives available.

The Belgium system is a very similar to the "imputed rental income" tax charge that existed in the UK until 1963. A clear benefit of this approach is that it provides a self-financing incentive to owners to maintain their properties, and probably contributes to balancing the market against tenure and condition distortions.

This approach was rejected in the UK in 1963 on the grounds of public policy – seeking to encourage owner occupation – and as a reform to simplify the tax system.

While a case can be made to reintroduce this approach it is unlikely to gather sufficient cross party political support to allow its implementation.

The alternative approach, of providing an incentive to owners to maintain and improve their property through allowing relief on the cost of works against income tax, is both simpler and fits better with current European practice. Michael Oxley et al's study of European approaches noted a favourable impact of a scheme introduced in France in 1997. This provides a tax relief of 20% of the cost of repair or improvement work up to a works cost of approximately £4,000 for couples (higher for families with children). Subsequently France has also reduced VAT on renovation work to stimulate activity.

It is very unlikely that the Treasury would accept such an approach unless a compensating source of tax income could be identified. Additionally a possible "extravagance" of the European approach is that improvements as well as repair and maintenance are allowed to qualify for relief. Limiting relief to repair and maintenance only would substantially reduce the cost, and may even help redress some of the imbalance in expenditure between non-essential improvements and necessary repairs noted in the first report of the HITF.

Regulation

An alternative or complementary approach to changes in taxation policy would be to seek changes in the regulations governing mortgage lending to homeowners. Recent years appear to have produced a noticeable "softening" in the extent to which lenders impose retentions on needed works identified in valuation surveys, and in the extent to which owners are "policed" to ensure identified repairs are carried out.

One approach, which could build in a real incentive for both lenders and borrowers to ensure property is kept in good repair, relates to the rules governing the Capital Adequacy of mortgage loans. At present rules on capital

adequacy are imposed on lenders by the Financial Services Agency, and domestic mortgage lending carries a weighting of 50%. Generally the safer a loan is judged to be the lower the required weighting, and the less of its own (equity) funds the lender needs to hold in reserve to make the loan. Current FSA rules are written in compliance with the 1988 Basel Accord, to which the British Government is a signatory.

An effect of increasing the weighting on capital adequacy on loans is to increase the interest rate the lender needs to charge to obtain the same return on its working capital. Thus a mechanism which placed a lower capital adequacy requirement on loans to properties in good repair, than on loans to properties in disrepair, would result in lenders needing to charge borrowers a higher rate of interest on poorer condition property. This could provide a powerful incentive to both lenders and home purchasers to ensure properties were brought up to a good standard of repair, and then properly maintained.

There appears limited scope within the 1988 Basel convention for this approach. However a major review of the Basel convention is currently underway. This is likely to be ratified and in force for 2005, and will allow far more discretion in the calculation of what is considered an adequate capital base for financial institutions. The new convention will require translation into national legislation, allowing the British Government considerable scope in interpretation and application. Key paragraphs of the current guidance and the opportunities afforded are identified as follows:

> *"Principle 4: Banks should identify the operational risk inherent in all types of products, activities, processes and systems. Banks should also ensure that before new products, activities, processes and systems are introduced or undertaken the operational risk inherent in them is subject to adequate assessment procedures."* [14]

When translating these rules into national legislation, the UK Government has an opportunity to identify the risk drivers and modelling methodology that it would expect lending institutions to consider in assessing risk, and therefore in quantifying what is to be an adequate capital base. On a day-to-day basis the FSA *will also have significant discretion* in deciding what constitutes an adequate capital base.

> "Role of Supervisors:
> *Principle 8: Banking supervisors should require banks to have an effective system in place to identify, measure, monitor and control operational risks as part of an overall approach to risk management.*
>
> *Principle 9: Supervisors should conduct, directly or indirectly, regular independent evaluation of a bank's strategies, policies, procedures and practices related to operational risks. Supervisors should ensure that there are effective reporting mechanisms in place which allow them to remain apprised of developments at banks.*
> Role of Disclosure
>
> *Principle 10: Banks should make sufficient public disclosure to allow market participants to assess their operational risk exposure and the quality of their operational risk management."* [15]

[14] "Sound Practices for the Management and Supervision of Operational Risk", Basel Committee Publications No. 86, December 2001

[15] Op cit

Identifying building condition as a risk driver is not only financially prudent but also makes social sense.

The only thing that stands in the way of using building condition as a risk factor in assessing capital adequacy (and therefore in associating building condition with the propensity of lenders to lend, and with the interest rate they charge) are the costs currently associated with the identification of building condition, and the lack of standardisation of such information once obtained.

Government has it within its power to correct this market failing in a cost effective way – something that would be to everyone's benefit. One route forward would be:

1. Initial (immediate) action by the FSA querying whether stock condition is factored into current models. (This might encourage use of stock condition as a risk factor, or at least serve to raise its profile as a Government priority, and incentivise lenders to address this issue more seriously than at present).

2. Subsequently, a statutory requirement identifying building condition as an identified risk factor in capital adequacy calculations when the Basle Convention amendments are brought into force in the UK. This would provide a major incentive to lenders. (And can perhaps be compared to the effect on Pension funds of the requirement to report on ethical investment).

3. Additionally, a statutory requirement on lenders to report on the condition of properties on which they have lent on an aggregated basis would assist in measuring collective housing stock condition – something local Authorities are attempting to do locally at great cost and with little common standard. This could be codified through initial valuations/stock condition surveys, and would fit closely with proposals put forward later for five yearly property inspections.

While this approach would take some time to bed down it has the potential to marry financial and common sense, and provide both an incentive and "driver" to owners and lenders to work together to ensure properties are kept in good repair.

The implications of this approach are that the market value of similar properties would adjust to more accurately reflect their current state of repair, and that mortgages on properties in poorer condition would attract a marginally higher rate of interest. A consequence of this is that there would be two significant incentives to owners to improve their properties. Firstly they would get far more, and possible all, of the cost of repair back on resale. Equally importantly carrying out the repairs needed to their property would reduce the cost of their mortgage repayments (allowing a slightly larger loan to be taken on if required, to fund the costs of the necessary works).

4 Owners' attitudes to repair and proactive measures

Attitudes and interventionist responses

An understanding of owners attitudes and approach to the maintenance of their homes is important in judging the likely success of any proactive measure to encourage owners to better maintain their homes.

Considerable work has been carried out in this area, both as part of the English and Scottish House Condition Surveys, and as part of a programme of work commissioned by the Joseph Rowntree Foundation, particularly "Make do and mend: explaining home-owners' approach to repair and maintenance",[16] "Crumbling Castles? Helping Owners to repair and maintain their homes",[17] and "Maintaining Interest: How mortgage lenders can help homeowners maintain their homes".[18] The First Report of the HITF provides a useful summary of Household attitudes to disrepair (paras 63-66).

In terms of developing proactive measures key attitudinal points to address are:

- Home owners do not see the need to plan ahead to tackle repairs
- Most owners do not actively carry out regular checks for repair problems
- While the majority of home owners are generally aware of the main problems with their properties:
  - Those on low incomes and older people are least aware
  - Owners tend to miss the more complex problems
  - Owners tend to delay too long before tackling problems. Discomfort is a key trigger for action, but costs may have risen substantially from the time of initial awareness.
  - Incomes, savings and *household preferences* determine whether people keep their home in good repair. For some people other (non essential) spending takes priority over repair. Some low income owners avoid seeking out repair problems
  - Where there is a perceived possibility of receiving a grant from the Council this acts as a major disincentive to self funding work

[16] "Make do and mend: explaining home-owners' approach to repair and maintenance" Philip Leather, Mandy Littlewood and Moira Munro. JRF/The Policy Press 1998

[17] "Crumbling Castles? Helping Owners to repair and maintain their homes" Philip Leather JRF March 2000

[18] "Maintaining Interest: How mortgage lenders can help home-owners maintain their homes" John Cockshott, Colin Jackson, Susan Pattison, Andrew Smith and Jim Sutcliffe (for The Bradford Network), JRF/YPS 1999

– Disrepair and dilapidation of other properties in the vicinity acts as a disincentive to carry out repairs, particularly in low value and vulnerable areas. (Though the converse is not necessarily true).

- Many people buy homes without a detailed survey
- There is a reluctance to borrow money for repairs
- Finding a trustworthy and competent builder is a major barrier to carrying out works, with trustworthiness generally rated more important than price.

The majority of interventionist measures put forward in the research or by interviewees are not dependant upon reserved powers. However some are, or have a clear “reserved” dimension. These relate:

1. To the use of mortgage lenders to raise awareness, and potentially to provide support, particularly for younger households, first time buyers, and long standing residents
2. To the provision of easier access to competitively priced loans for home repair and improvement, particularly for older or low income households who have paid off their existing mortgage or are dependant on income support
3. The use of selected tax incentives to encourage property maintenance and “essential” improvements

The attitudinal points identified above indicate that that successful proactive measures are likely to be ones that:

- Raise an early (or earlier) awareness of outstanding repair issues (this is particularly important for younger households, first time buyers, and long standing residents)
- Impact on household preferences for expenditure
- Facilitate the repair process through removing owners concerns and (perceived) inadequacies to mange the process
- Make the process affordable and address reservations over borrowing money to fund repair

The majority of owners do not own outright, but have a mortgage secured on there home. There was a difference of viewpoint between different mortgage lenders as to the appropriateness of lenders becoming engaged in an educational or supportive manner with their home borrowers. However a number of points clearly came out in discussion.

Some lenders are very positive towards the establishment of schemes which would provide better information and advice to first time purchasers, and to schemes which would more easily facilitate owners managing the repair and maintenance of their homes. For example production of a homeowner’s handbook which drew purchasers attention to their repairing obligations as detailed in the purchase contract, and provided clear guidance on good home maintenance practice, would appear to be a simple and practical exercise.

Indeed some lenders appear to have carried out considerable exploratory work on ways to better inform their borrowers, and in adition to provide property inspection and maintenance packages. More than one lender has considered the practicalities of encouraging a scheme of this nature, incentivised by a marginally lower interest rate (and justified internally on the grounds of reduced default risk from better condition property). On a large scale it would probably be possible to reduce the direct cost of an appropriate three or five yearly survey to around £100 for conventionally constructed homes.[19]

The reasons given for these initiatives not having been taken forward on a widespread basis were interesting, and have regulatory implications.

For advisory schemes for new purchasers lenders were concerned that anything which acted in any way as a deterrent to purchasers, for example by requiring additional time, appearing "bureaucratic", or raising concerns, would have a significant disincentive on the lenders' ability to attract new customers.

Given the very competitive and commercial nature of the home loan market there was a strong perception that any single lender, or group of lenders, adopting a proactive approach to alerting borrowers to repair issues would be disadvantaged in the marketplace, and would lose an unaffordable amount of business. Additionally the costs of taking such action, and making information available, may appear small, but were judged to be commercially significant in the highly competitive environment of marketing home loans.

It is therefore very unlikely that lenders will take any action to raise purchasers' awareness of repair and maintenance issues unless regulatory requirements are introduced (via the Financial Services Agency) to either require such action, or provide a financial incentive to take it.

At present there is considerable regulatory guidance, which lenders have to comply with, relating to ensuring borrowers are fully informed of the financial implications of the loan they taking on, and to ensuring that the type of loan is appropriate to their circumstances. Almost all mortgage agreements include an obligation on the borrower to keep their property in well maintained and in good repair. It can be argued that ensuring an understanding of the obligation to keep their property in good repair could sensibly be included in the "duty of care" advice and checks lenders currently have to demonstrate to customers. Such an approach could have the benefit of alerting and informing purchasers, particularly the more naïve first time purchasers, of the costs, and associated responsibilities, of maintaining their home.

Additionally such an approach could also have a positive impact on the increasing reluctance of lenders to *require* anything more than a property valuation for their lending purposes. Encouraging lenders to insist on a higher standard of survey before granting a mortgage, would focus greater awareness of and emphasis on the owners immediate and future repair and maintenance requirements. Lenders reluctance to insist on a higher standard of survey appears to be driven by a mixture of cost competition (to minimise customers transaction costs) and partly by deeper concerns relating to perceived regulatory and potential legal (liability) issues from moving away from lending other than on the "pure" criteria of value (and customers credit worthiness).

[19] The author has been given brief details of a comparable Dutch scheme "Monumente Wacht" which appears to be viable on the basis of a £50 charge

Clear interest, even enthusiasm, was detected amongst some lenders for schemes which would enable them to offer survey and maintenance packages to some home owners. At present however lenders considered that the benefits they could offer from such a package were not in themselves quite sufficient to achieve a high enough “critical mass” of take-up to achieve the necessary economies of scale.

Should it be possible to establish schemes of this nature on a large scale, there is little doubt that they would have a substantial impact on property condition. The focus and design of such schemes would also serve to address the attitudinal requirements identified earlier for successful proactive measures. In particular such schemes could be packaged to remove owners concerns over managing and funding the repair process and to weigh customer expenditure preferences towards maintenance expenditure.

Incentives to take forward such a scheme would be achieved by inclusion of property condition as a “risk driver” in assessing capital adequacy, as considered at the end of the last chapter, or could alternatively be provided through allowing a targeted reduction of VAT on repairs and maintenance expenditure commissioned through a lender managed “Survey and Maintain” package. Accessing tax reductions is a significant attitudinal driver, and would appear likely to be an adequate incentive to ensure a rapid development of lender led “survey and maintain” plans for borrowers.

Access to affordable loans for repair and improvement

Reasonable access to affordable loans for repair and improvement are available to most existing borrowers. Problems (relating to reserved powers) exist however for owners who do not have a mortgage, or who are dependant on income support to pay their mortgage interest. Typically owners who do not have a mortgage will be older households who have paid off their loan, though some will be heirs and divorcees. Most are groups who have a higher propensity to disrepair, and who may find accessing affordable finance to be expensive and difficult. It is therefore particularly important that the ability of these home owners to access affordable borrowing is optimised.

The reserved power barriers that exist include:

- Consumer Credit Act (1974) rules relating to loans under £25,000
- Office of Fair Trading (OFT) rules relating to marketing and advice on equity sharing loans
- Issues relating to the provision of Income Support on Mortgage Interest (ISMI) on home improvement loans for unwaged low income households

Consumer Credit Act (1974) rules relating to loans under £25,000

The Consumer Credit Act places consumer safeguards on loans made to individuals unless they are “exempt agreements” or over £25,000. This is generally a worthy requirement and aims to ensure consumers are fully informed about the terms of the loan agreement they are entering into, provides useful safeguards, and aims to exclude questionable practice and dubious operators.

However a consequence of the regulation is that small loans made to homeowners for repair and improvement of their homes become substantially more expensive (seemingly by an extra 3%-10% interest charged pa), due to the cost of compliance by lenders.

The Government has in part recognised this conflict of objectives, and includes in its definition of “exempt agreements” loans made by local authorities and certain Home Improvement Agencies to homeowners. Additionally an extension of a current mortgage (even if virtually repaid) does not currently fall within the CCA constraints (though this is presently being reviewed by the EU).

However the regulations currently apply to loans (under £25,000) made by normal mortgage lenders and Housing Associations to homeowners to improve their homes. There are several adverse consequences to this, including:

- Home owners seeking to fund their own improvements can expect to pay a higher rate of interest (unless they have an existing mortgage to extend), and are therefore financially disadvantaged by the impact of “protective” legislation.
- Housing Associations are disadvantaged when attempting to provide “holistic” renewal services to home owners in their areas of operation.
- It becomes administratively easier for Local Authorities to provide loans directly rather than enabling loans from the private sector. Unfortunately loans provided directly by Local Authorities count as “capital expenditure” in terms of their budgets and the Public Sector Borrowing Requirement. Direct provision of loans by Local Authorities is therefore a very ineffective use of resources if Banks and Building Societies could easily provide the same funding.

Amendment of the Consumer Credit Act to widen the range of Organisations able to make exempt loans for home repair and improvement could prove of significant benefit to homeowners by reducing costs of loans and increasing their supply. One route to this would be by updating the Consumer Credit (exempt agreements) Order 1989.

Consumer Credit Act and Office of Fair Trading Rules relating to marketing and advice on equity sharing loans

Equity sharing loans are loans which are lent against a proportion of the equity (value) of a property, rather than as a fixed sum. Normally such a loan would not be repaid until the sale of the property, or death of the owner.

A key advantage of equity sharing loans is that they normally require much lower repayments by the owner than conventional borrowing. This is of direct benefit to lower income owners (particularly pensioners on a fixed pension), and is also a significant financial benefit to government where either interest payments are being funded via income support, or where the local authority is providing top up “affordability funding” (as in the scheme below).

One equity loan for home improvement and repair scheme is funded by Rochdale Council and delivered by West Pennine Housing Association. This requires the owner to pay no interest during the life of the loan. On sale of the

property the Housing Association receives back its principal and an increase reflecting any increase in the value of the property.[20]

Where equity-sharing loans are commercially provided it is likely that the monthly interest payments will be significantly less than an equivalent conventional loan (reflecting the higher final capital repayment). This is of immediate benefit to any borrower financing the cost of the loan out of direct income, or to the Government/Council when funding the cost of the loan through public subsidy.

A significant barrier to the development of equity sharing loans is the (completely justified) requirement of the Consumer Credit Act for potential lenders to advise borrowers of the likely interest rate on their loans as an APR (Annualised Percentage Rate of charge). Unfortunately the definition of APR required makes it impossible to calculate for equity loans, due to the length of term and final selling price being unknown.

On a pragmatic basis the Office of Fair Trading allows the Director of the OFT to grant a "Notice of Direction" for any scheme where the Director considers it "impractical for the applicant to comply with the requirements of the Regulations" (and by implication which is otherwise acceptable). Such a "Notice of Direction" allows a recipient lender to avoid having to comply with the specified provisions stated in the regulations, usually on condition that an alternative schedule for calculating an APR under various scenarios is applied. The author's *understanding* is that the "Notice of Direction" is a direction to the officers of the OFT not to prosecute such an identified scheme for non-compliance with the Consumer Credit Act, rather than a method of granting "legality" to the scheme.

The experience of seeking to obtain a "Notice of Direction" for equity loans to fund homeowners' repairs has in any event proved to be very long and complicated for organisations following this approach.

This is clearly an undesirable barrier to provision, and works against the interest of both homeowners, and agencies seeking to support owners in finding funding for repairs to their homes.

An appropriate amendment of the Consumer Credit Act to provide clear and simple rules governing information requirements on the provision of equity sharing loans would be the most constructive remedy. Alternatively a "global" "Notice of Direction" covering all equity sharing loans linked to home improvement which fell within defined parameters may also address this issue.

Access to mortgage interest payments for owners on Income Support

Low-income tenants have the repair and improvement costs on their homes funded in full through Housing Benefit. Many commentators have commented on the inequity of the situation facing low-income owners (particularly pensioner owners) who have managed to fund the cost of their home, but cannot afford the cost of keeping it in good repair.[21]

The current position is that owners who are eligible for Income Support may apply for the cost of their interest on a home repair loan to be funded through

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[20] "Equity Release" Paper by Peter Lowe Consultancy to Housing Corporation "New Tools in Urban Regeneration" Seminar held 2 July 2002 in Leeds

[21] "Half the Poor: Home Owners with Low Incomes" Roger Burrows and Steve Wilcox Centre for Housing Policy University of York CML December 2000

"ISMI" – Income Support on Mortgage Interest. However ISMI will only be approved for loans (or part of) relating to repair work, and any expenditure on improvements will be disallowed. Additionally it is not possible for an owner (or agency) to apply in advance for confirmation or "firm guidance" that interest on any specific loan will be funded. The following anomalous situations thus exist:

- An eligible home owner can (probably) claim ISMI on a loan for repairing an old central heating system, but not for installing a new system (even if they do not have one at all).
- Owners may almost certainly be eligible for ISMI on a repair loan, but will be deterred from commissioning the works and borrowing the money due to uncertainty.
  (NB Up until the mid-1990's it was possible to obtain advance confirmation that ISMI would be paid, which greatly facilitated obtaining loan finance).
- Lenders cannot be certain that the owner will be eligible for ISMI, and are therefore far less likely to advance the funds (at least without a guarantee of alternative funding from a public body).

There would also appear to be a strong public interest case to be made for ISMI to be available on loans that provide a designated range of improvements to an owner's property. While there is a public policy debate to be resolved on whether subsidy for state assisted private sector home improvements should be funded nationally through the benefit system, or local via improvement grants, it would appear to be both more equitable (both between tenures and geographic boundaries) to fund home improvements up to a pre-defined standard through the benefit system. The mechanism of using ISMI to fund interest payments on home repair loans for eligible individuals would appear to equitable, and have the advantages of being cost effective, reducing the need for capital subsidy, and ensuring that owners contributed the maximum amount they can reasonably afford from their own resources.

The recent commitment by the ODPM to establish a ten-year target to achieve the "Decency Standard" in all private sector properties (in England and Wales) which are homes of vulnerable individuals would indicate an appropriate precedent and approach on this issue.

A strong case can therefore be made that changes to Income Support rules should be introduced which:

- allow payment (to eligible owners) of ISMI on loans taken out to procure improvement works necessary to bring their homes up to the "Decency Standard" (or appropriate Scottish alternative)
- allow owners (or an appropriate agency) to establish in advance whether they would be eligible for ISMI on a loan taken out to fund repairs and improvements.

Equal opportunities issues relating to home improvement loans

An emphasis on home improvement loans as a means of funding owners' disrepair costs will impact adversely on Muslim home owners as charging and paying interest on loans is in conflict with Islamic law.

There are no objections within the Quran to Muslims borrowing money, only on the payment of interest. A sophisticated Shariah compliant finance industry thrives in the major Islamic countries, but very few financial institutions offer Shariah-compliant products in Britain. The United Bank of Kuwait offers a range of Islamic banking products, but only has one UK branch, and appears to limit its lending. Recently HSBC have opened a subsidiary HSBC Amanah Finance which seeks to offer fully compliant products and is regulated by Shariah Supervisory Committee. However access to funds, particularly home improvement loans, is very restricted.

Islamic finance of a mortgage or home improvement loan would be based on the principle of Murabaha, where the finance provider purchases the desired commodity (for which the loan would have been taken out) from a third party and resells it at a predetermined higher price to the capital user. By paying the higher price in instalments the capital user has effectively obtained credit without paying interest.[22]

Where Councils or Agencies provide loans on an interest free basis there is no conflict with Islamic law. However any requirement or desire to cover the cost of the capital generates problems. Improvement staff working with the Asian community report the absence of appropriate loan finance to be a significant barrier. Often there are informal sources of Shariah compliant credit available within the Muslim community. However these are limited in availability and using informal finance for home improvements can restrict the total pool of credit available within a poor community.

Additionally there does not appear to be a readily identifiable Shariah compatible equivalent to an interest only loan, which is one of the main tools for assisting older people improve their homes.

Two reforms at the National level which may help to address some of these issues are:

- firstly the financial regulations governing Councils' abilities to on-lend, should be amended to allow them to issue Shariah-compatible loans
- secondly the rules relating to ISMI should be amended to reflect the nature of Murabaha, though it is acknowledged that this would be a complex process.

Additionally it is worth noting that many Muslim home purchasers suffer financially when purchasing their home, due to the requirement for the property to be bought and sold on by the finance company, incurring double stamp duty. There is some evidence that discussions are in hand on ways of resolving this issue.

[22] Information on Shariah compliant finance can be found at (for example):
The website of the Institute of Islamic Banking and Insurance (London) www.islamic-banking.com
The website of HSBC Amanah Finance www.amanahfinance.hsbc.com
See also "Different but not that different" The Guardian Saturday September 1 2001
"Islamic Banking holds mainstream appeal" Guardian Monday May 27 2002

5 Available options and an interlinked approach

The preceding chapters have identified and mapped out a significant number of policies which could impact favourably on stock condition in the owner-occupied sector. The adoption of each on an individual basis would be likely to have a positive impact. The adoption of all options would be expensive and potentially wasteful.

This chapter summarises the main options identified, and seeks to provided a view as to whether they will work alone or together, and draws attention to issues that may arise from their use. Finally the chapter sets out a strategy for combining a number of the options identified in a way which generates a funded driver towards good repair.

The main options

Option (summary)	Observations
Reduction of VAT to 5% for repair, maintenance and essential improvement work, with the tax loss offset if necessary by either higher stamp duty or VAT on new properties.	This is a very widely supported option, would have an impact on a freestanding basis, and would also encourage the use of reputable, VAT registered contractors. If widely applied it would result in a substantial reduction in tax income, and would need to be balanced by matching increases in tax or charges as discussed in the main report. It could also be applied in a more cost effective way, by focusing the VAT reduction on designated localities, and/or on works necessary to bring properties up to an agreed standard (e.g. the Scottish equivalent of the English "decency standard"), and/or linking the VAT reduction to "survey and repair" packages managed by lenders and other reputable organisations such as approved home improvement agencies and insurance companies
Allowing costs of repair, maintenance and essential improvement work to be offset against income tax.	This option can be expected to be popular and likely to have an impact, and could be freestanding. However it would be regressive in impact – providing least help to those on lowest incomes, administratively cumbersome, and the high cost is unlikely to be acceptable to the Treasury. Additionally there are technical impediments to adopting this approach.

Option (summary)	Observations
Identifying property condition as a “risk driver” under the implementation of the revised Basel Accord (on capital adequacy)	This could lead to major incentives for both borrowers and lenders to ensure properties were well maintained, and would have the added advantage of having no financial cost for the Government. Indeed an increase in maintenance work may actually marginally increase the tax take. While this approach could be applied on a “free standing” basis, its implementation could be greatly facilitated and enhanced by linking it to regulatory or tax incentives for lenders (and others) to provide “survey and maintenance” packages to owners, as described in detail later.
Guaranteed payment, and “pre-approval” of ISMI (Income Support on Mortgage Interest) for eligible owners on loans for repair and improvements to bring their homes up to a Scottish equivalent of the English “Decency Standard”	This change is free standing and could provide a major incentive to elderly and other low income owners to keep their property in good condition, and would greatly facilitate the work of approved home improvement agencies and others working with low income owners. This approach would also ensure a maximum contribution from owners to the maintenance of their homes, and would greatly reduce the demand and need for improvement grants.
Careful reform of Consumer Credit Act legislation relating to marketing and advice of equity sharing loans	The use of equity sharing loans maximises the owner’s capital contribution to the cost of repair, while minimising interest payments. This makes equity loans more affordable on a limited income, and reduces the cost of any state subsidy provided (such as ISMI). The changes required should have no significant costs, and would be free standing.
Widening the range of organisations able to make “exempt” loans for home improvement and repair	Owners with no current mortgage who need to borrow less than £25,000 for home improvements will normally find their loan falls within the regulatory requirements of the Consumer Credit Act. These impose substantial costs on lenders, which make the loans more expensive. Allowing reputable lenders, housing associations and other designated organisations to make “exempt” loans for home repair and improvement would substantially reduce homeowners’ borrowing costs and make affordable loans easier to access. The changes required should have no significant costs, and would be free standing.

Option (summary)	Observations
No taxation on income from the first £6,000 of sinking fund investment per property	The taxation of investment income on sinking funds at the rate of 34% is widely seen as unfair and a disincentive to good practice, and is politically unpopular. It is particularly inequitable for low and non income tax payers, though safeguards need to exist to minimise tax avoidance by higher earners. It is also an expensive tax to identify and collect, and widely avoided. The option that no tax should be paid on interest on the first £6,000 of sinking fund, per property, is made to reflect the annual cash ISA allowance for two people. This is a free standing proposal, and should have minimal impact on total tax take.
Legislation to reduce the costs of Shariah compliant finance for Moslem homeowners, to enable councils to issue Shariah compliant loans, and allow low income owners with loans based on the principle of Murabaha access to ISMI	Essentially this is equal opportunities legislation which would place Moslem homeowners dependant on a loan to fund improvements on a more "equal cost" basis to other owners. British law and benefit regulations place significant transactional costs on Shariah compliant finance which act a sharp deterrent to taking out a Shariah compliant home improvement loan, and provides no assistance for low income borrowers equivalent to ISMI on loan interest. This option would provide useful encouragement to many Moslem owners to borrow money to improve their homes, would be freestanding, and would reduce dependency on improvement grants in low income areas.
Regulatory action to encourage mortgage lenders to raise purchasers awareness of and engagement with repair and maintenance issues, possibly by giving lenders the same "duty of care" to lenders with regard to ensuring borrowers understand and can afford maintenance, as they have with regard to ensuring borrowers understand and can afford their financial products.	This option could be freestanding, or linked to the Basle Accord initiative (above). Some lenders appeared very supportive of taking positive action to educate and alert home owners to maintenance issues, but were discouraged from being proactive by concerns relating to the intensely competitive nature of the home loans market, that they would discourage purchasers, or generate marginal but commercially sensitive addition costs. For this initiative to succeed minimum obligations would need to be laid down by the FSA, and applied to all mortgage providers. This option would have minimal cost implications for the government, would ensure that home purchasers in effect "paid" for receiving appropriate advice, and can be expected to have a small but useful impact on stock condition through raised awareness, and a small reduction in inappropriate purchases.

Option (summary)	Observations
Provision of regulatory and/or financial incentives to encourage the development of "survey and repair" packages by lenders and other responsible organisations.	This option can be viewed as a "delivery vehicle" to facilitate and encourage responsible maintenance by owners. The option is not freestanding, but needs to be combined with several of the incentives above. This option is considered in more detail below.

The above table identifies the main options available (requiring reserved powers) to encourage owners to properly maintain their property. All options place the primary responsibility for funding repairs with owners, and are compatible with the Scottish Executives wish "to establish a legislative and administrative framework which actively encourages owners of private houses to invest in regular maintenance, improvements and repairs".

An interlinked approach

This final section seeks to set out a strategy for combining a number of the identified options in a way which generates a funded driver towards good repair. It is based on the observations that key barriers to owners maintaining their properties effectively can be summarised as:

- a lack of awareness of what action to take
- inertia (putting off repairs until a problem emerges)
- problems finding reliable contractors
- availability of funding (and preference for amenity expenditure over maintenance)

Additionally it draws on the premises that:

- most people seem surprisingly well motivated by a tax break
- lenders include clauses in their mortgage conditions requiring owners to maintain their properties, and that there should be some responsibility shown by lenders to encourage compliance with these terms

The concept is that the following should be offered by *all* lenders (or their nominee) as a package:

- On (say) every fifth anniversary of *house purchase*, the lender should commission a maintenance survey of the owner's home.
  - this survey would be paid for by the owner (in the same way as lender-provided home insurance)
  - the owner would alternatively have the option to commission their own survey.

- The survey would identify immediate and imminent outstanding works, and would include:
  - a schedule specifying the work needed
  - an indicative price
  - an offer to commission (and supervise where appropriate) the works on an undertaking that they would not cost more than 5% above the indicative price (but with some safeguards for defined exceptional circumstances).
- The survey would be matched by an offer from the lender to fund the cost of works, payable by either:
  - increased annual payment within the current term
  - extension of term (but not normally beyond retirement age)
- The owner would have the option of:
  - accepting the offers to arrange and fund the work (a simple tick box acceptance letter is envisaged)
  - accepting the offer to arrange the work, but would fund separately
  - accepting the offer to fund the work, but arranging own contractor
  - undertaking to manage all matters themselves.

This package would be greatly enhanced by willingness of the Treasury to provide a tax incentive, the most appropriate of which would appear to be a reduction in VAT to 5% on all works carried out under this scheme. However in the longer term the consequences of including repair condition as a risk driver within the Basel Accord may provide sufficient incentive (due to differential interest rates) to ensure owners “lock in” to the arrangement to ensure they remain on lower interest rates.

To enfranchise older owners it would also be appropriate to offer a guarantee of ISMI to eligible owners on loan advances for repair and maintenance work procured under this scheme.

If this could be introduced as a full package then it would appear to provide a coherent “driver” which would address many of the current reasons for disrepair in the current housing market, and over time make a substantial contribution to improving the condition of the housing stock. To a large extent the policy would work by a combination of natural inertia (“it all happens, I just sign the form”), gentle persuasion and valued incentive.

Discussions with potentially interested parties raised a number of issues:

It is judged unlikely that (at least initially) such a scheme would achieve a high take-up without some form of tax or financial incentive. Implementation of the revised Basel Accord is some time away. To encourage a more immediate large scale implementation and take-up a robust case would need to be made to the Treasury. This could emphasise the increased VAT and other taxes that would accrue from enhanced building trade turnover, and from directing home maintenance work towards approved contractors and away from the “cash economy” and DIY, and emphasising the public good achieved. Additionally

any gap in tax take may be fundable through a slight further increase in stamp duty.

Lenders were concerned that unless the scheme applied equally to all lenders then customers would migrate to the least imposing lender. It is partly for this reason that the surveys are referenced from the anniversary of initial purchase, rather than (re)mortgage.

Concern was also raised about repair “cost to value” issues. However this issue is greatly ameliorated by the relatively fast rate at which capital is repaid when interest rates on mortgages are low. For example, assuming a borrowing rate of 5%, then after 5 years an owner with who had taken out a £50,000 repayment mortgage over 25 years would have repaid over £5,500. Even if there had been no increase in property value this should normally be adequate to cover the cost of any repairs arising in the first five years of purchase.

There is also an issue concerning lenders’ responsibilities for lending on repairs if a property were in a declining area with falling values. In part this relates to FSA guidance on lending proprieties, and in part to a desire not to have to increase debt above a declining value. Any scheme would need to be developed in line with FSA requirements. The need to address issues of disrepair in declining areas is very important. However a perspective could be taken that a scheme of this nature raises wider questions about investment, lending and management of declining areas, which require a cohesive strategic approach.

This “interlinked approach” was initially developed and consulted on on an “incentive only” basis. However the impact of the pending Basel Accord will provide an alternative or complementary driver for the above approach. In particular the imposition of a requirement on lenders to weight the capital adequacy of their loans according to property condition would result in higher interest charges for owners of properties in poor condition, and a coalition of interest between lender and owner to ensure properties were fully maintained.

Additionally any requirement for lenders to provide the FSA with details of the condition of the stock they manage would provide a very powerful motivator to introduce the regular five year condition surveys. Owners would then be motivated to carry out essential repairs not only by the carrot of tax relief and “easy” finance, but by the stick of higher interest rates in the event of non-compliance.

It is suggested that this “interlinked approach” may be developed to address many of the key reasons for disrepair in the owner-occupied sector, and if implemented “in the round” could help redress much of the market distortion which is currently observed in the owner-occupied property sector.

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