P R E C *i* S

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

While most owners are clearly able and willing to maintain their properties satisfactorily, a significant number appear to struggle. This minority appears either unable or unwilling to manage and resource effective home maintenance. This research identified and explored policies aimed at improving the state of repair of homes in owner occupation sector in Scotland, with a particular focus on policy options in areas reserved to the Westminster Parliament, that is tax, benefits and financial regulation. A number of regulatory and policy options are identified. The key findings were:

- No UK tax or regulatory incentives were identified which encourage owners to repair or maintain their properties Indeed there are a number of significant disincentives which act to discourage owners from repairing and maintaining their homes
- A number of policy options that appear to be within the remit of the Scottish Parliament are limited by the impact of wider UK regulation or legislation

Positive action which could be taken:

- Reduction of VAT to 5 per cent for repair and maintenance work, with the tax loss offset if necessary by either higher stamp duty or VAT on new properties.
- Identifying property condition as a "risk driver" under the implementation of the revised Basel Accord (on capital adequacy) could lead to major incentives for both borrowers and lenders to ensure properties were well maintained.
- Guaranteed payment of Income Support on Mortgage Interest (ISMI) for eligible owners on repair and improvement loans to bring their homes to the proposed Scottish Housing Quality Standard.
- Reform of Consumer Credit Act legislation relating to marketing of and advice on equity sharing loans, and widening the range of organisations able to make "exempt" loans for home improvement and repair, could greatly enhance availability of affordable home improvement loans, and enhance the impact of public subsidy.
- No taxation on the first £6,000 of sinking fund investment per property.
- Legislation to reduce the costs of Shariah compliant finance for Moslem homeowners.
- Introducing financial and regularity incentives to promote and develop "survey and repair" packages for homeowners, backed by price guarantees and loan funding.
- Placing enhanced responsibilities on all mortgage lenders to ensure home purchasers are fully alert to their repairing obligations.

Different levels of policy

Disrepair policy operates at two levels, national and "local" or "targeted". At the national level policy impacts on all owners. It is at this level that long-term strategic considerations should apply to encourage and ensure that owners of properties in good condition keep them that way, and that owners of properties that fall into disrepair are persuaded and able to repair them from their own resources.

At the local or targeted level policy can be directed to a specific locality or client group where disrepair problems are clearly visible. Local or targeted policy requires additional and more concentrated resources, and implies proactive and interventionist measures that are appropriate at the national level.

Policies which use powers reserved to the Westminster Parliament fall broadly into two classes:

- options which are fully dependant on reserved matters, and which generally impact at the "national" level.

- options which are generally within the powers of the Scottish Parliament, but which are limited in their effectiveness by reserved matters. These tend to relate to local or targeted initiatives.

National Level Policy Options

These relate to the way the British tax, benefit and financial regulation system appears to provide clear disincentives to owners to repair and maintain their homes, and to the lack of incentive to owners to invest in the maintenance of their properties.

Three disincentives are identified at the national level:

- the high (17.5 per cent) rate of Value Added Tax (VAT) on repair and maintenance expenditure .

- distortions in the property market which do not fully reflect the cost of outstanding and future repairs in a properties value.

- a high rate (34 per cent) of taxation on interest generated from the investment of sinking funds (this applies to communally owned properties only).

No UK tax incentives were identified which encourage owners to repair or maintain.

This contrasts strongly with other European countries where property ownership is generally taxed at a much higher level than in the UK, but where quite substantial tax incentives are provided to offset maintenance (and normally improvement) expenditure against either income tax or capital gains tax on residential property. Some countries also provide VAT reductions on maintenance expenditure.

The main policy options available in the UK are:

- allowing repair and maintenance expenditure to be offset against income tax. This would be popular, would have an impact, and is common practice in other European countries. However it would discriminate against low income owners, and the cost is unlikely to be acceptable to the Treasury.

- reduce VAT to 5 per cent for repair and maintenance work. This option is widely supported amongst key commentators. The Treasury would almost certainly require a matching increase in other property taxes to fund the cost, and is unlikely to support such a broad reduction.

However the Treasury have in recent years supported VAT reductions for schemes targeted at particular situations, and it may well be possible to make a case for a tightly focused scheme funded either through increased stamp duty or imposing VAT on the first sale of new property.

Repairs add little to value
A major problem is that the marketplace values properties in poor repair little differently from similar, well maintained, homes. Owners, therefore, are not

"rewarded" for repairing by a proportionate increase in value.

No clear mechanism to remedy this is available but the following approaches could partly address this issue by forcing an awareness of the costs of outstanding and imminent maintenance at the time of property sale:

- to require all mortgage providers to give advice to borrowers on property costs and maintenance, and on owners' responsibilities and obligations, in the same way as they are required to do when advising on mortgage terms and conditions and on interest rates. Such a change would only be acceptable to the mortgage industry if applied equally to all lenders, and would require guidance to be issued by the Financial Services Authority (FSA)

- to hold lenders more accountable for the condition of properties on which they lend. At present all mortgage agreements include clauses emphasising the responsibility of the borrower to maintain the property in good condition, but such clauses are rarely, if ever, enforced.

Current regulation of mortgages also makes no meaningful distinction between lending on property in good or poor repair condition.

However significant changes are proposed to the rules governing mortgage lenders' Capital Adequacy under a major review of the Basel Accord. This will allow the British Parliament and the Financial Services Agency an opportunity to specify the risk drivers and modelling methodology it would expect lending institutions to consider in specifying risk.

Linking in a requirement for lenders to monitor and report on the state of the properties on which they lend would generate an interest rate differential for loans on property in good and poor repair, and would provide a strong incentive for both lenders and owners to ensure properties were kept in good repair.

To reduce the taxation of sinking funds
The high rate of taxation on interest from investment of sinking funds is inequitable (individuals can save up to £3,000 each year tax free with a cash ISA) and works against prudence and good practice.

A straightforward policy option would be to remove all tax on the first £6,000 (per dwelling) of funds held in sinking funds for residential properties. Alternatively a more complex tax reduction structure could be sought, reflecting property size, age and value.

Better Provision of Local and Targeted Initiatives
The main report considers a number of issues and proactive measures to assist owners to maintain or improve their homes. These would normally be addressed through local initiatives, but are often hindered by matters requiring reserved powers to resolve. Issues identified and the relevant reserved power policy matters are listed below:
Facilitating affordable and accessible home improvement loans
Recently a consensus appears to have emerged that it is likely to be much more cost effective for local authorities to move from a grants system to one where most of the cost of repair works would be funded by loans. This is in line with the views of the Housing Improvement Task Force that where possible owners themselves should fund the cost of works to their properties.

Various barriers impede the development of this approach, including:

- 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.

The Way Forward

Policies to ensure an effective loans-based approach include:

• amendments of the Consumer Credit Act to widen the range of organisations able to make exempt loans for home repair and improvement, and to provide clear and simple rules for organisations providing or promoting equity based loans. This could significantly reduce the cost of loans for repair and improvement, and usefully enhance the range and affordability of loan products available.

• seek agreement with the Department of Works and Pensions (DWP) to revise the rules governing Income Support on Mortgage Interest (ISMI) to:

i. allow owners (or an appropriate agency) to determine in advance whether they would be eligible for ISMI on a loan taken out to fund repairs and improvements.

ii. allow payment (to eligible owners) of ISMI on loans taken out to procure improvement works necessary to bring their homes to the proposed Scottish Housing Quality Standard.

While being mainly positive about a loan based approach to repair and improvement the main report identifies some adverse equal opportunities issues for Moslem homeowners. This is due to shortage of Shariah-compliant finance, and some adverse "incidental" costs generated by the taxation system which disproportionately impact on Shariah-compliant financial transactions. Some partial remedies are identified.

A linked approach: survey and repair
It is suggested that lenders could be incentivised to provide a "survey and repair" package of five yearly property condition surveys on their properties. This would offer a full package to owners of survey, arranging and supervising identified repair work (with a price guarantee), and arranging finance. There could be an incentive of reduced VAT on work carried out under this arrangement. This could be complimented by a higher rate of interest chargeable on properties in disrepair if the owner declines to have the works carried out.

About the Study

This study was carried out by Graham Martin, an independent housing researcher and consultant. The emphasis of the study was identifying policy options. This was approached through an initial literature review, followed by input from key practitioners and interviews with key stakeholders and experts.

Related Communities Scotland Research

A number of related publications including this research are available from the Housing Improvement Task Force website at www.scotland.gov.uk/about/DD/H2/00015254/page1750164308.aspx.

Further Information

Further information and copies of the research report can be obtained from Neil Ferguson, telephone 0131 479 5313, email fergusonn@communitiesscotland.gov.uk. The report is also availabe on our website, www.communitiesscotland.gov.uk.

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