STABILISATION OF PROPERTY PRICES AND THE PROVISION OF AFFORDABLE RESIDENTIAL ACCOMMODATION (P.68/2001): COMMENTS

Presented to the States on 16th October 2001
by the Policy and Resources Committee

STATES OF JERSEY

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Comments

The Policy and Resources Committee has considered the report and proposition entitled "Stabilisation of Property Prices and the Provision of Affordable Residential Accommodation" (P.68/2001), lodged au Greffe by Deputy A. Breckon, together with the comments on that report and proposition presented by the Finance and Economics Committee on 4th September 2001.

The Policy and Resources Committee has consulted with the Finance and Economics, Planning and Environment, Industries and Housing Committees and after considering their comments, responds to each paragraph of Deputy Breckon's proposition as follows -

"to agree, in principle, that positive action should be taken to encourage home ownership in the Island and the stabilisation of residential and commercial property prices and rentals...... -"

The Committee agrees that the principle of home ownership is already an important element, though not the only element, of States policy relating to the housing market. The overall objective being to ensure there is a sufficient supply of accommodation to meet the reasonable demands of all residents to obtain secure and affordable homes. In this context, the Committee concurs with the view that the availability of housing is a also major issue with respect to policies to counter poverty in the Island.

However, the Committee has substantial doubts as to whether the various proposals in this proposition would encourage home ownership and would lead to the stabilisation of residential and commercial property prices. The Committee further doubts whether the proposals would contribute usefully towards the overall objective and notes that some of the proposals might also be expected to have wider and in some cases undesirable, effects on the Island economy.

(a) that the Finance and Economics Committee be requested -

(i) to investigate the introduction of taxation on any capital gain received on the sale of land, residential or commercial property within 20 years of its purchase to discourage the sale of such property within a short period of time; and

The Committee notes that the objective of this measure is to discourage sales of property after short periods of time and that Deputy Breckon is of the opinion that fast sales are linked to land that was "bought and sold within a short period for inflated amounts of money, with the end result being that the first-time buyer ……[had] to pay between £80,000 and £100,000 for the plot of land alone."

The Committee believes that it would be unlikely that a tax on capital gains could provide a solution to this problem. The purchase price of first-time buyer homes is mainly determined by market conditions when those new homes are sold, rather than the sum of the costs of producing new houses (i.e., land cost plus construction cost, etc.) leading up to the point of sale. It is therefore the purchasing power of those eligible to buy which determines the final selling price. If price was not used as the principal allocation mechanism - if access were by ballot or decision of the Housing Committee - then final prices may not be determined exactly in this way. But even under these circumstances, the existence or otherwise of capital gains tax within the production chain would be unlikely to affect the mechanism which determines the final selling price.

The Committee judges that the introduction of a capital gains tax would not remove the motivation for 'speculation', though it might reduce the rewards by 20 per cent and, thus, it would also be likely to encourage avoidance behaviours.

The 20-year time period would produce a significant tax liability differential across the 20-year threshold, especially if the tax were based on nominal capital gains. There would, therefore, be an incentive to avoid the tax if sellers were approaching that threshold. One result might be an incentive to hold property empty for a number of years, rather than sell at the time when the property was no longer needed, for example, if a long-time resident were to leave the Island after owning a property for, say, 18 years.

Note: The holding of empty property does not appear to be a significant problem at present in Jersey. Deputy Breckon has anticipated the possibility that this proposal might lead to empty homes by proposing a financial penalty for owners who leave residential property empty. (This is assessed at (d)(iv) below).

In addition, there would probably be several side-effects. In particular, it is likely to make movements within the housing market much more difficult, which in turn is likely to lead to an even less desirable resource allocation within the housing market. The reason for this is that moving within the housing market by simultaneous sale and purchase would incur a tax of 20 per cent of any capital gain made over the 20-year period. For example, if a family with children wanted to buy a larger house, while an older couple whose children have left home wished to buy a smaller house and both have lived in their houses for ten years, the tax implications of a ‘swap’ would be considerable (see attached Appendix). To avoid this problem, an exclusion of the tax from the principal home would be necessary, as is the case in the United Kingdom.

Experience in other jurisdictions suggests that such taxes are difficult to enforce, expensive to administer and generate a relatively low return. A capital gains tax would represent a significant reversal of policy for Jersey and could see an overall reduction in taxation income should financially mobile individuals leave the Island as a consequence of its introduction.

If renting of property were relatively easy and would not significantly affect the realisable market value of the property, then the incentive to delay sale may translate into an incentive to rent out the property until the 20-year rule is satisfied, rather than sell it straightaway. A further complication, especially over longer time periods, would be the difficulty of distinguishing between pure capital gains and improvements and dealing with inflation. For example, would the tax be levied on cash or real capital gains?

The Committee firmly believes that the fundamental problem in the Island housing market is the shortage of houses compared to demand, which translates into high house prices. An associated feature is a market where agricultural land has a low value and housing land has a high value. Taxing transactions associated with that process would be unlikely to have a significant influence on the price differentials observed in the market place, although it could transfer some of the increase in property value to the States.

It should also be noted that, under certain market conditions, with a large number of buyers chasing far fewer properties, it might be possible for sellers to pass on the full value of the tax to buyers. This would add to the rate of increase in house prices in the Island.

(a) that the Finance and Economics Committee be requested -

(ii) to bring forward for approval legislation to provide that mortgage interest relief should only be granted in respect of residential property which is owner-occupied and which is the owner’s principal place of residence and that such relief should be limited to the first £260,000 of any mortgage on that property;

The Committee believes this proposal has some merit in principle. Overall levels of subsidy for house purchase would be reduced and this should eventually make a difference to the rate of increase in house prices. However, the proposal would be difficult to impose on existing loans (this is not made clear in the Report and Proposition) and there could be additional costs of administration. Further, the proposed cap would be set at a high level relative to average current house prices and would take several years to have much impact. It could also become an irrelevance at a time if there were a deflation in the housing market.

The Committee believes that the proposal might be more appealing if it were introduced as a first step in a phased reduction of relief. Popular opposition to the capping principle would probably be high and it would be preferable to consider a change of this type within the context of a more radical review of tax and spending policies, where the problem of ‘winners and losers’ might be addressed on an Island-wide equitable basis. The Committee therefore proposes that the issue of interest relief on house purchase should be looked at within the context of the overall review of fiscal strategy, which is currently in process.

(b) to agree that all Committees of the States shall henceforth ensure that the rent review clause in any new agreement for the leasing of property, entered into by the public, either as lessor or lessee, or the renewal of any such agreement, specifies that annual rent increases shall be limited to a maximum of 2.5% and shall not be linked to the increase in the Jersey Retail Price Index;

The Committee notes that this would be in stark contrast to current price trends in other parts of the housing market, that it would result in a substantial subsidy to lessees in publicly rented housing and that States spending would have to rise to compensate for income losses at a time when pressures on States spending are already growing rapidly. It is hard to conceive of a situation where private sector rents are rising at less than 2.5 per cent, but the Committee suggests that in such circumstances, public sector rents should follow the downward trend to keep the market in equilibrium, if in practice, public sector rent increases were to avoid setting a rental floor.

(c) to request the Planning and Environment Committee, in conjunction with the Policy and Resources, Industries and Housing Committees, to compile, and publish on a regular basis, statistics on the number of new dwellings completed in the Island;

The Committee considers this to be a helpful proposal. Data gathering is split at present between several departments and there is a good case for standardisation in the collection and compilation of data on the total housing stock, including demolitions. Improvements to data would enable a more soundly-based approach to the development of Island policy for the housing market, and provide a proper foundation for an assessment of any impact of States' interventions in that market. The Committee has requested the Policy and Resources Department's Head of Statistics, in conjunction with officers from other departments, to consider this issue and to bring forward proposals for improved data collection in the near future.

(d) to request the Housing Committee -

(i) to review the Committee's policy on the level of maximum or fair rents for States accommodation and the operation of the private sector rent rebate system to ensure that the maximum payable in rent by tenants is no more than fifteen per cent of the Island's average earnings index;

The purpose of this measure would be to reduce the rent paid by private-sector tenants. The Committee believes the immediate impact would be to increase States expenditure on rent rebates by a matching amount, which would indeed benefit recipients of rent rebates. However, it would also impose a tax burden on the wider population and, as a side effect, the Committee is also concerned that some private sector landlords might be driven out of the market, at a time when more, not less, units are needed.

Limiting rent levels to a proportion of the Island's average earnings index would mean that the rebate paid by the States would not relate to the particular circumstances of the tenant. All other things being equal, a tenant with high earnings would receive the same rebate as a tenant with low earnings. Similarly, a tenant in a small house/flat would pay the same rent as a tenant in a large house, if the free market rent for both were above the 15 per cent ceiling. The Committee believes this kind of situation would and should not be acceptable.

The Committee recognises that estimates, prepared on behalf of the Housing Committee, indicate that the current system of rent subsidies is less expensive and better targeted than the system proposed by the Deputy. However, the Committee also notes and supports the actions being undertaken to review the existing system within the context of the Low Income Support initiative.

(d) (ii) to review the operation of the Rent Control Tribunal and bring forward for approval legislation to grant the Tribunal powers to give due consideration to Jersey's average earnings index and the levels of real income and pensions when determining actual rental levels;

The Committee notes that this proposal appears to recommend stricter controls over rent levels for individual households. Whilst appearing reasonable, the Committee, however suggests that, as a result of such a proposal being introduced, individual rent setting decisions by the Rent Control Tribunal would almost certainly become the subject of detailed scrutiny and disagreement and the Tribunal would probably become embroiled in long-running debates over issues of equity and consistency between tenants. The Committee further is of the view that the proposed scheme would be very difficult to administer and, again, would be likely to drive private landlords out of the market.

(d) (iii) to review the current methods of registration and regulation of lodging houses and, in particular, to consider the introduction of legislation to regulate the prices charged by lodging house owners or their agents;

The Committee notes that this proposal recommends analysis of this sector, rather than specifying, in any detail, the controls which might be applied. However, the Committee also recognises that the proposal is, as are (d)(i) and (d)(ii) above, made consequent upon a desire for price control and some additional forms of security.

The Committee generally recalls that the history of rent controls and security of tenure in other communities has been an unhappy one. The Committee further recalls that the LECG Report, published in November 2000, strongly supported the decision of the Housing Committee in 1991 to remove price controls from this sector. The Committee believes that there are several unwanted outcomes which might be expected if rent controls were reapplied -

- incentives to change the tenure type (e.g., to sell to owner-occupiers), would be introduced, though this could perhaps be tempered by the introduction of offsetting rules;

- the encouragement of side payments from the tenant to the landlord (e.g. 'key money') so that the tenant pays about the same as the 'uncontrolled' rent, but by different means; and

- harassment of tenants to effectively undermine the security of tenure which had been “awarded”;
- almost certainly a reduction in the pool of available lodging houses.

The Committee notes that there are supply constraints in this sector, and attempts to control some of the symptoms of this situation would almost certainly decrease supply or increase demand. The Committee recognises that this would exacerbate the problems rather than solve them, and suggests that it would be better to increase supply, or reduce demand, through direct intervention, rather than target the symptoms of the fundamental problem.

(d) (iv) to identify, and maintain a register of, all unoccupied residential property and consider the introduction of a method of financially penalising owners who allow residential property to remain vacant for more than one year;

The Committee notes that there is no evidence in the Report which would suggest that this has become a major problem in Jersey, but recognises that a clearer picture will be presented after final analysis of the Census. The Committee further notes that property owners are unlikely to have an incentive to leave their properties empty, without good reasons, since they would be giving up rental income and, in any case, they would make capital gains whether the property was in use or whether it was empty. For isolated cases where a property remains empty without ‘good reason’, the Committee notes that the Housing Committee may, as it has in the past, use its statutory powers to ensure conversion to residential use.

(e) to request the Industries Committee to give due consideration to the provision of more affordable homes for sale and rental when considering applications under Part III of the Regulation of Undertakings and Development (Jersey) Law 1973, as amended.

The Committee recognises that the Industries Committee considers housing issues already, in relation to States policies on first time buyer homes and social rented housing, in dealing with Part III applications, and the implications which those applications might have for the supply of luxury homes. It is difficult to see how the Industries Committee might make a greater contribution to this objective than it does at present.

APPENDIX

Stylised example of the impact of capital gains tax on movements within the housing market

Situation

- Family 1 - children left home.
- Family 2 - two children, aged eight and ten.
- Home 1 - three large bedrooms, purchased in 1991 for £200,000.
- Home 2 - two small bedrooms, purchased in 1991 for £100,000.
- Current selling prices - Home 1, £350,000; Home 2, £200,000.

Outcome

With no capital gains tax -

- Family 2 need access to £150,000 more (as a loan, realising other assets, etc.) in order to move from Home 2 to Home 1. Family 1 gains access to additional wealth (or reduction in debt) of £150,000 by moving from Home 1 to Home 2.

With capital gains tax of 20 per cent -

- Family 2 will need access to an additional £170,000 (£150,000 plus 20 per cent of the selling price of Home 2- £200,000 - less the purchase price of Home 2 in 1991 - £100,000) in order to move, while Family 2 will benefit by £120,000 (£150,000 less the tax of £30,000 on this gain) from the move.

The net results are -

- Family 2 needs to find an additional £20,000.
- Family 1 is £30,000 worse off.
- The States will be £50,000 better off.

Note: This stylised example excludes stamp duty, legal fees and other associated costs and makes no provision for an inflation allowance against the sum liable for tax.