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Residential - The Budget - June 2010

Coalition government's emergency budget offers few surprises, but how will it affect the housing market?

The emergency Budget review on 22nd June set out the five-year plan to rebuild the British economy, incorporating the longest and deepest set of cuts in post-war history.

While widely anticipated the increase in CGT was not as punitive as many expected. Gains on asset disposals will be taxed at the pre-existing rate of 18% for basic rate taxpayers - but will be increased to a flat rate of 28% for higher rate taxpayers.

The proposed 25% cut in government department budgets over the next four years will see the spending on housing cut by the Department for Communities and Local Government.

Increasing VAT from 17.5% to 20% next year could hit the property sector hard. As a transaction-based tax this will have a direct impact on disposable income. Cross-sector retail sales may suffer lower volumes as prices are squeezed.



The implications of the emergency budget: analysing the effect on the housing sector

The emergency Budget review on 22nd June set out the five-year plan to rebuild the British economy. With principles around deficit reduction, enterprise and fairness it brings several changes for the UK residential sector.

Since the formation of the new government there has been a steady stream of policies, guidelines and principles with implications for the housing market. From the coalition agreement, through to the Queen's Speech and the latest emergency Budget announcement, this bulletin summarises the impact for the residential sector.

Policy – Housing Delivery

While there were no nasty surprises the emergency Budget announcement will have done little to calm the nerves of housing developers who were looking for the government to honour spending commitments on new housing schemes. The proposed reduction in government department budgets by 25% over four years will not help those waiting on housing lists or those unable to buy their own homes. The reduced budget at the Department of Communities and Local Government (DCLG) brings into doubt an increasing number of housing projects. The DCLG has stated already there is a £780 million "hole" in required funding and implications for further cuts will be met with disappointment.

The Homes and Communities Agency (HCA), which invested close to £5 billion across the sector last year, has put new programmes on hold after being told to save £230 million from its budget this year. This includes reducing the budget available for the Kickstart programme by £50 million.

The latest government publications illustrate that existing home owners will remain the priority for policymakers. While the central thrust of the new government housing policy supports the theory of increasing housing ownership – through more lending and greater housing supply – the economics of the situation leaves much of this undeliverable in the short term.

Looking at the housing implications

The undernoted analysis moves policy-by-policy through the areas of the HM Treasury Budget report identifying the key stimulus and repercussions for the housing sector. For further information the section reference in the full report is highlighted in brackets.

Value Added Tax (section 1.44)

The decision to increase the standard rate of VAT from 17.5% to 20% brings the UK closer to the wider European Union average. The measure will be implemented on 4th January 2011 with an anticipated net tax gain of £8 billion per year. Receipts from VAT are expected to be circa £81 billion in 2010-11.

However, increased VAT could hit the property sector hard. As a transaction-based tax this will have a direct impact on disposable income, so cross-sector retail sales may suffer lower volumes as prices are squeezed. This rise will apply to maintenance and renovation of properties. The Budget makes no change to the zero VAT rating for household essentials or to the reduced rate of VAT.

The VAT increase will make inroads into the public sector borrowing deficit; however the noteworthy aspect of this change for the housing market is the inherent inflationary pressure this may herald. As prices are forced up the Bank of England will be tasked to respond, in order to keep inflation in check. This may force an increase in the base rate sooner rather than later. This comes despite the chancellor noting that the government will target tighter fiscal policy to enable interest rates to stay low.



Banking Levy (section 1.63)

Prior to the Budget announcement the coalition government stated their intent to introduce a banking levy and in this Budget the Chancellor pressed ahead with proposals to clamp down on bonuses in the financial services sector. The government will introduce a levy based on banks' balance sheets from 1st January 2011 intended to encourage banks to move to less risky funding profiles.

The Government will also take action on unacceptable bank bonuses. Whilst this reaction might be seen as justified, it is important this tax is not imposed on individuals but instead should be fielded by the corporate entity. Further measures to reduce the bonus due to individuals will have an adverse impact on investment in the housing market, particularly in Central London.

Green Housing (section 1.79)

Proposals are set out to establish a Green Deal for households through legislation in the Energy Security and Green Economy Bill. This is intended to allow individuals to invest in home energy efficiency improvements designed to pay for themselves from the savings in energy bills.

Around 27% of the UK's carbon footprint is emitted from the housing sector, and this initiative is targeted at cost-effective carbon reduction. The Government will also continue to work on green financial products providing opportunities to invest in the infrastructure necessary to support the green economy. The environmental impact of Budget measures will be assessed in more detail as proposals are developed.

Local Enterprise Partnerships (section 1.89)

The Government proposes to allow locally-elected leaders working with local business to lead economic development. As part of this change, Regional Development Agencies (RDAs), which have been in existence since 1999, will be abolished through the Public Bodies Bill. A White Paper later in the summer will set out detailed proposals. The role of the Local Enterprise Partnerships (LEPs) will incorporate dealing with the shift to a more locally driven planning regime, promoting simplified planning consents in areas of business growth through the use of Local Development Orders.

Plans to assist areas exposed to the cuts in public spending will see the establishment of a Regional Growth Fund in 2011-12 and 2012-13 to encourage private sector led growth.

Capital Gains Tax (section 1.96)

The increase in CGT was one of the most widely forecast changes in the emergency Budget. In reality, prior to the announcement, this was probably the single most heavily analysed, debated and criticised move the government was likely to make. The tax rise applies to non-business activities with relief for entrepreneurs.

As of midnight on 22nd June, capital gains on asset disposals will be taxed at the pre-existing rate of 18% for basic rate taxpayers - but will be increased to a flat rate of 28% for higher rate taxpayers. As in the past, investors will still be able to realise up to £10,100 of gains per year tax free. There is no taper relief or indexation applied to counteract inflation.

The instantaneous impact of the CGT change does remove the feared time-lag associated with this tax change. If the government had set an implementation date in the future, presumably around the start of the new fiscal year, to apply the higher 28% rate, the market may well have seen a more marked increase in secondary stock. This would have had a deflationary effect on pricing. Many landlords or second home owners would have been inclined to drop the asking price in order to dispose of the property in a timely fashion, thus circumventing the necessity to pay the new higher rate.

In effect the capital gains tax taken from the housing market is indicative of the strong capital growth the market has delivered for investors over the long-term. With significant local and global capital targeting the UK market, and the south-east in particular, the effect of the damage may be limited.



Non-domiciled Taxation (section 1.98)

As announced in the coalition agreement, the government plans to review the taxation of non-domiciled individuals. There is no further clarity at this stage. The review will assess what changes may be required to the existing rules to ensure that non-domiciled individuals make a fair contribution to reducing the deficit.

Housing Benefit (section 1.102)

The Government proposes the introduction of a package of reforms to housing benefit from April 2011 onwards. Expenditure on housing benefit is currently around £21 billion per annum, and the government aims to cut £1.8 billion each year through the term of this parliament. The maximum allowable housing claim will be capped, including changing the percentile of market rents used to calculate Local Housing Allowance rates, and indexing these in line with CPI from 2013-14. Local housing allowance rates will be set at the 30th percentile of local rents.

There will be a system of time-limiting the payment of full housing benefit, with claimants expected to look for work. Housing benefit will be restricted for working age claimants in the social rented sector who are occupying a larger property than their household size warrants. From April 2011, Local Housing Allowance Rates will be capped at £250 per week for a one bedroom property, £290 per week for a two bedroom property, £340 per week for a three bedroom property and £400 per week for four bedrooms or more.

Council Tax (section 1.110)

The government has confirmed a plan to work alongside local authorities to freeze council tax at its present rate in 2011-12. Some areas of the country may even see a cut in rates. A proposal has been agreed for central government to compensate local authorities who keep spending under control. Across many localities council tax effectively doubled during the tenure of the previous government administration so this will be viewed as good news for homeowners and tenants alike. It is estimated the average family will save over £35 per year.

Stamp Duty (section 1.111)

As announced in the coalition agreement, the government will review stamp duty land tax (SDLT) relief for first-time buyers. At present the exemption remains in place on properties valued up to £250,000. No date for this review was published. There was, however, no specific rebuke of the previous Labour administration's Budget plan to implement a 5% rate of stamp duty for properties above £1 million. This will still be introduced from 6 April 2011. The government will examine whether changes to the rules on SDLT for high value property transactions are needed to prevent avoidance in this area. This will disproportionately affect the market in London and the south-east, with an additional £10,000 tax bill as a minimum.

Stamp duty thresholds have failed to keep pace with the rate of house price inflation across the past decade. The optimal implementation would be for stamp duty to be applied at a marginal level like income tax, so buyers would only pay the percentage above a certain level rather than the temptation to artificially force properties to fall under a set boundary.

Support for Mortgage Interest (section 1.112)

Support for Mortgage Interest (SMI) is the government package to support homeowners who have lost their jobs make mortgage payments and avoid repossession. The rate paid is set at 1.58 percentage points above the BoE base rate, and it has been frozen at 6.08 per cent since late 2008 although interest rates have fallen significantly. To offer a more sustainable basis for SMI and better reflect mortgage costs, it is proposed that SMI will be paid at the level of the Bank of England's published Average Mortgage Rate from October 2010.

Inheritance Tax (section 2.126)

Rather than follow the pre-election Conservative manifesto and extend the nil-rate Inheritance Tax (IHT) band, from £325,000 towards £1 million, we have seen IHT allowances frozen at the 2010-11 rate of £325,000 until 2014-15. From the perspective of the property market this is likely to maintain the volume of probate sales in the market, rather than see estates retain properties by virtue of a decreased exposure to IHT.

LTV Ratios

After much conjecture, one omission from the Budget, and bright note for the industry was that mortgage loan-to-value (LTV) ratios have not been capped at this stage. Whilst additional qualitative and quantitative lending powers have been conferred to the Bank of England the chancellor stopped short of implementing an outright cap in this Budget. Capping LTV rates at too low a level would have left every homeowner above that rate in a difficult position when looking to remortgage or acquire a new home.





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