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First-time buyers and stamp duty: regional differences

- Rising property prices – and taxation policy – are continuing to create affordability problems for first-time buyers. Our data shows that the proportion of them paying stamp duty has risen significantly in the last year.
- Data we are publishing today also shows that there are big regional differences in the payment of stamp duty by first-time buyers. In northern England, 82% do not pay any stamp duty at all, and more than two-thirds of those in the north west and Yorkshire and Humberside avoid paying it. By contrast, only 3% of first-time buyers in London do not pay stamp duty.
- There is a similar pattern with higher rates of duty. A quarter of first-time buyers in London now pay duty at 3% because their home costs more than £250,000. But in northern England and Yorkshire and Humberside, this affects less than 1% of first-time buyers – and only 3% in the north west.
- The impact of stamp duty on first-time buyers is at odds with other government measures designed to help them. Lenders support the recent expansion of the government's HomeBuy scheme providing help for key workers – but many of them still have to pay stamp duty when they buy their home.
- Stamp duty is not only increasing the tax burden on home-buyers, it is distorting the housing market. But our proposed reforms would address both issues.
- Ending the practice of levying stamp duty at the highest marginal rate on the whole price of the property would remove market distortion. This could be achieved with no loss of revenue to the government, if necessary. Home-owners could then be protected from a growing tax burden by indexing stamp duty in line with house price inflation.

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First-time buyer affordability

Data we released earlier this month underlined the continuing difficulties faced by first-time buyers. Since 2000, the average size of a first-time buyer loan has increased at twice the rate at which incomes have grown. And declining affordability caused the typical income multiple for first-time buyers to tick up to 3.27 in August, from 3.24 in July and 3.08 in August last year.

The proportion of income that first-time buyers spent on mortgage interest payments also rose in August. At 17.1%, it is now at its highest level since February 2005. Despite this, however, the proportion of income that first-time buyers currently pay in mortgage interest remains affordable by historic standards – and is lower, for example, than the average for the eight years between 1984 and 1992. During that period, with much higher and more volatile interest rates than we have now, the proportion of income spent on interest payments peaked at 28.1% in 1990.

Although affordability for first-time buyers is becoming more challenging – partly as a result of the higher deposits they have to pay – borrowing costs are lower and more stable than they were in the 1980s and 1990s. And the wide choice of products available to consumers means that buyers who are worried about the prospect of higher interest rates can hedge against them by choosing a capped or fixed-rate loan

Trends in lending

Growing affordability problems in recent years have contributed to a decline in the proportion of loans for house purchase made to first-time buyers. In August, they accounted for just 35% of the total, the lowest proportion since we began our current run of data in April 2005. In absolute terms, however, the numbers have been rising. August's total of 38,100 first-time buyers was 9% higher than the 34,900 recorded a year earlier.

Against the backdrop of mounting affordability problems, figures we released earlier this month – showing the increasing numbers of first-time buyers now forced to pay stamp duty – created something of a media stir. Our figures showed that the proportion had jumped from 48% to 56% in just 12 months. And only 15% of home movers escaped paying stamp duty in August, compared with 21% a year earlier.

There was an interesting reaction to our data from the Treasury. It argued that our figures included a number of divorcees and others who could not be truly classified as first-time buyers because, although they may be renting now, they have been owner-occupiers sometime in the past. The Treasury appeared particularly keen to disprove media reports that more than half of first-time buyers now paid stamp duty.

What our data shows

In pursuing these arguments, however, the Treasury chose to ignore the key point we were trying to make. We have always acknowledged that our data is broad-based. Indeed, within the last 15 months we have published



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two separate pieces of detailed research examining what our figures show about the different types of purchasers captured by our first-time buyer data. We found that some reported first-time buyers were, in fact, 'returners' – those who may have been renting just before buying their property but who had also been owner-occupiers earlier in their lives. One of our articles estimated that returners accounted for perhaps 20% of those classified as first-time buyers.

The key point, however, is that all home-buyers – whether they are new entrants, returners or existing owner-occupiers – are paying increasing amounts of stamp duty. The first-time buyer data that we published for August can be compared on a like-for-like basis with the figures for 12 months earlier. Both contain a similar proportion of returners. It is indisputable, therefore, that the data provides clear evidence of a strong year-on-year increase in the number of first-time buyers forced to pay stamp duty.

Perhaps more significantly, the proportion of first-time buyers paying duty will continue to grow rapidly unless there is a change in government policy. There is a conflict between the government's stated desire of easing affordability for first-time buyers and the increasing amount of tax it requires them to pay – and that conflict looks set to intensify. It is already clear that this is likely to be a key issue in the next general election, even though that may be more than three years away. This summer, the Conservatives flagged up affordability for first-time buyers as central to their policy development.

The regional impact of stamp duty

If taxing first-time buyers is already a hot political issue, the regional impact of stamp duty raises the stakes further. Our regional data is based on property valuations, rather than transaction prices, but that does not alter the broad findings. What emerges is that there are very big differences in the effect of stamp duty on first-time buyers in different parts of the country.

In northern England, for example, 82% of first-time buyers do not currently pay any stamp duty at all. In other areas that are traditional Labour strongholds, like the north west and Yorkshire and Humberside, the proportion of first-time buyers that do not pay tax is lower but still high – at 70%. In many parts of the north, therefore, stamp duty has relatively little impact on first-time buyers and is perhaps not a significant electoral issue. But that contrasts sharply with London – where the government still holds more Parliamentary seats than any other party. There, only 3% of first-time buyers avoid paying stamp duty. And in south east England, only 17% manage to buy their first home without paying tax.

A similar pattern emerges when we look at regional differences in the impact of higher rates of stamp duty on first-time buyers. In northern England and Yorkshire and Humberside, less than 1% of all first-time buyers currently pay more than £250,000 for their first home and therefore find they are liable to pay duty at 3%. And in the north west, just 3% of first-time buyers fall into this category. But in London a quarter of buyers are already paying more than £250,000 for their first home, and are therefore paying at least a further 3% of the purchase price in stamp duty.

Conflicts in policy

As the burden of tax on first-time buyers rises, it will become more difficult for the government to reconcile the contribution stamp duty on property sales makes to government revenue with its impact on such a politically



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sensitive group as young people – many of whom are already weighed down with higher student debt as a result of other government initiatives.

There is also a conflict between stamp duty policy and modest new initiatives like the expanded Homebuy scheme that seek to help key workers buy their first home in south east England (see [Lenders support new Homebuy scheme](#)). Clearly, the government wants to expand HomeBuy because of the growth of property prices relative to incomes. But having to pay stamp duty compounds the problem for key workers trying to buy their home. And there is clearly an anomaly in raising the barriers to home-ownership through taxation but then subsidising people in certain types of employment.

The case for reform

We have consistently argued for reform of stamp duty to remove the distortions it creates in the housing market and to ensure that the tax burden on home-ownership does not continue to grow relentlessly. In past submissions to the government, we have argued that this could be achieved by:

- ending the practice of levying stamp duty at the highest marginal rate on the whole of the price of the property; and
- indexing tax thresholds in line with house price inflation, so that home-owners do not pay increasing amounts of duty over time.

Levying stamp duty at the highest marginal rate on the whole price of the property forces sellers to agree prices just below the thresholds at which higher rates of tax apply, thereby distorting the market. Our data shows clear evidence of this distortion, with large numbers of properties sold for prices just below tax thresholds and only a very small number of transactions at prices where higher rates of tax would apply.

In 2005, for example, when for most of the year properties bought for less than £120,000 were exempt from stamp duty, 14,500 properties were sold for between £119,000 and £120,000, while there were only 805 transactions at prices between £120,000 and £121,000. Similarly, with the 3% threshold for stamp duty at £250,000, 21,703 home were bought for between £245,000 and £250,000, while only 798 buyers paid prices between £250,000 and £255,000.

Conclusion

Market distortion would largely disappear if stamp duty worked like income tax, with higher rates applying only to the amounts over each threshold. The government could achieve this without any loss of revenue by revising existing rates and thresholds for stamp duty. Once these reforms were implemented, home-buyers could be protected from the creeping effects of taxation by indexing thresholds in line with house price inflation. Such an approach would be more consistent with government aspirations and policy initiatives to promote home-ownership.



“It is clear that this is likely to be a key issue in the next general election – even though that may be three years away”



Lenders surprised by OFT referral

We welcomed the second phase of the report on payment protection insurance (PPI) by the Financial Services Authority (FSA) – but were surprised by the decision of the Office of Fair Trading (OFT) to include mortgage payment protection insurance (MPPI) in its proposed referral to the Competition Commission.

The OFT decided to include MPPI even though its own market study pointed out that there was greater access to stand-alone cover for mortgages than for other types of PPI. We will look more closely at the OFT's reasoning before responding formally.

Our work on MPPI clearly demonstrates that it is possible to create a credible product with a compliant sales process. We hope that borrowers who need MPPI are not put off taking it because of more general concerns about the wider PPI sector.

Reporting its findings, the FSA said that regular premium PPI sold in the prime mortgage sector had been excluded from the second phase because its earlier work had found relatively few compliance failings among firms in this sector.

In the broader PPI sector, the FSA was concerned about sales practices and the provision of information for customers, including exclusions that prevent them from making claims under their policies.

Insurers warn over building in floodplain

Further building in the floodplain should be avoided because climate change increases the risk of flooding, according to the Association of British Insurers (ABI). In the last four years, nearly 800 new housing developments have been built in areas of high flood risk against the advice of the Environment Agency, it said.

Insurers believe that in London alone 500,000 properties, 200 schools, 16 hospitals and eight power stations are already situated in the floodplain.

Rising flood risk threatened some of the areas targeted by the government as sites for new homes and “could turn these dreams into nightmares,” said Jane Milne, the ABI's head of property.

Insurers say sensible planning now will reduce significant costs in the future. The ABI is committed to continuing insurance wherever possible for existing customers but said it would look “more critically” at newly built property.

- Gross lending hit a new September record of £29.5 billion, our data showed. Lending was 11% lower than the all-time record of £33 billion in August, but 7% up on September last year.
- Timber frame housing achieved almost 20% of the market share for all new housing built in 2005 and will account for 25% by 2008, according to the UK Timber Frame Association. In south east England, 40% of new housing was timber frame.
- Lender ING Direct and bridging finance specialist Bristol & West Investments have become members of the CML. Software provider Focus Solutions Group has become an associate. The CML now has 158 members and 105 associates.





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Lenders support new HomeBuy scheme

Individual lenders are backing a new scheme to expand home-ownership among first-time buyers, which is also being supported by the CML.

We helped develop the new scheme, called Open Market HomeBuy, which was launched at the start of this month by the Department for Communities and Local Government (DCLG). Under the scheme, borrowers get a mortgage for 75% of the property's value and two equity loans of 12.5% each, one from the lender providing the mortgage and the other from the government. At this stage, four lenders are contributing to the scheme: the Bank of Scotland, Nationwide Building Society, Yorkshire Building Society and Advantage, which is a subsidiary of the Morgan Stanley group

The 12.5% loan provided by the lender, in effect, stretches the government's pot of money twice as far, offering the potential for the scheme to help twice as many borrowers. Although the scheme is relatively modest in scope – with the government estimating that it will help 40,000 first-time buyers over the next five years – it is a positive step for the housing market, helping to extend the personal and social benefits of home-ownership. It also provides a platform that lenders may be able to build on in future.

The government has allocated £230 million to the scheme, which is still being piloted at this stage. But if it is judged a success when it is reviewed in 18 months' time, the government could make more money available.

Unlike a shared equity scheme, in which the borrower owns part of the property and rents the rest, HomeBuy gives the purchaser sole ownership of their home from the outset. Local HomeBuy agents will decide who is eligible for help but the scheme will be targeted at key workers, social tenants, those on the housing register and other first-time buyers identified as a priority by regional housing boards. The scheme will focus on London, the south east and eastern England, but may also be available to a more limited extent outside these regions.

Helping 40,000 first-time buyers over five years is a relatively modest contribution, given that there are more than a million housing transactions every year. Given that scale, we do not believe that the scheme will distort the way the housing market operates. Nonetheless, it is important that shared equity goes hand-in-hand with a real increase in housing supply. If the scheme is popular, the government needs to make sure there is enough housing available.

We are supporting Open Market HomeBuy because it gives the government and lenders experience of working in a public/private partnership and could be the basis for a much more flexible approach to home-ownership in the longer term. Ultimately, shared equity could allow home-owners to increase or decrease their equity stake as their circumstances change. So, as well as helping first-time buyers on to the property ladder, it could provide an option for borrowers who can no longer afford to pay the cost of a full mortgage to reduce their equity stake. At this stage, however, we support the launch of the Open Market HomeBuy pilot scheme as an opportunity for first-time buyers.

