

## **Submission to the Work and Pensions Committee's inquiry on support for housing costs in the reformed welfare system**

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1. This note draws on previous analysis by IFS researchers, collating material relevant to the committee's inquiry. More detail is available in previous publications which are referred to where relevant. In this note we focus on the likely effects and merits of the specific reforms introduced under the current government. A discussion of the broader underlying principles and trade-offs involved in designing support for housing costs in the UK context can be found in Adam (2013).<sup>1</sup>

### **Changes to local housing allowance from 2011**

2. The changes referred to here are: setting local housing allowance (LHA) rates at the 30<sup>th</sup> percentile of the applicable rent distribution rather than the 50<sup>th</sup>; capping rates at the four-bedroom rather than five-bedroom rate; introducing overall national caps – binding in parts of London – on rates for each room band; and abolishing the £15 per week over and above rent that could be claimed where rent was lower than the applicable LHA rate. The change to the way that LHA rates are uprated from April 2013 is discussed separately below.
3. A key uncertainty is how the reforms affect rents, and therefore how the pain is ultimately shared between tenants and landlords. The impacts on rents will depend on the relative sensitivities to rent levels of supply of, and demand for, private rental accommodation; and on whether landlords of LHA tenants are willing and able to let their properties to non-LHA claimants who are unaffected by these reforms (if they are, then renters *not* on LHA could gain from the reforms via lower rents).
4. As part of the independent consortium commissioned by DWP, IFS researchers are conducting econometric analysis to estimate the impacts of the reforms on rent levels and on property types rented. Early evidence presented in the interim report<sup>2</sup> was based on a comparison of the flow of new claimants shortly after the reforms took effect in April 2011 with the flow of new claimants shortly before the reforms took effect. This found that rents were little lower for those claiming shortly after the reforms, so at least initially the pain of the LHA cuts was felt mostly by tenants rather than landlords. There was also little sign that the sizes of properties – as measured by number of bedrooms – rented by claimants had been affected. Quantitative analysis conducted by consortium partners at the Centre for Regional Economic and Social Research (CRESR) at Sheffield Hallam University did, however,

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<sup>1</sup> Section 5 of S. Adam, 'Housing taxation and support for housing costs', Chapter 2 in T. Callan (ed.), *Budget Perspectives 2014*, Economic and Social Research Institute, 2013 ([http://www.esri.ie/publications/latest\\_publications/view/index.xml?id=3771](http://www.esri.ie/publications/latest_publications/view/index.xml?id=3771)).

<sup>2</sup> <https://www.gov.uk/government/publications/monitoring-the-impact-of-changes-to-the-local-housing-allowance-system-of-housing-benefit-interim-report-rr-838>.

suggest that the geographical distribution of LHA claimants had been affected, with a reduction in central London.

5. This early evidence is not a definitive guide to long-run effects. It may take tenants time to negotiate lower rents; or to find different accommodation; and landlords may, for a time, informally accept less than the contractual rents that are recorded in the administrative data used for this analysis. The next stage of the evaluation will incorporate existing claimants too, and will be able to investigate longer-term impacts.
6. Insofar as the cuts do ultimately fall on claimants, they are clearly affecting a low-income group, on average. The cuts are correspondingly effective at strengthening work incentives, since less generous LHA rates mean people have less support to lose by moving into work or increasing their earnings. The removal of people's ability to claim up to £15 of LHA in excess of their rent will lead to a less efficient use of the housing stock, since claimants will no longer have that £15 incentive to find a cheaper property. The cuts to LHA rates have the opposite effect, however, as claimants will tend to face more of the cost of living in higher-rent properties.

### **Uprating of local housing allowance rates capped at CPI inflation**

7. This is an ill-conceived way of reducing housing benefit expenditure which will have very undesirable long-run effects. Politically, it is also likely to be harder to reverse the longer it is left, because the potential gains and losses for households from a return to a more rational system will grow in magnitude over time. We therefore recommend that this be reconsidered with some urgency.
8. Assuming that real rents continue to grow, LHA rates relative to rents will decline, and in the long run the proportion of rents covered by LHA will shrink ever further. This in itself looks odd: if we are to have a benefit that exists explicitly to help with housing costs (rather than the wider cost of living), then its generosity should bear some relation to the general cost of housing. This is not to pass judgement on whether its generosity should be reduced. But if the government wants to reduce housing benefit spending further, it would be more equitable and transparent to, for example, explicitly reduce further the relevant percentile of the local rent distribution on which LHA rates are based (from the 30<sup>th</sup>). Under current policy, this percentile will implicitly be reduced as long as real rents grow, but by an amount that will vary (both over time and across the country) according to unknown future rates of rent growth.
9. In terms of how LHA entitlements vary across the country, this policy replaces a link to current rent relativities with a link to historical ones. Geographical rent differences as of 2012–13 – before the change in indexation – will determine LHA rate differences permanently thereafter. There is no justification for a system in which someone is entitled to more LHA than someone else in (say) 2025 simply because they live in an area where rents were higher back in 2012–13. This is of

serious practical consequence: rents at local levels are volatile, and relative rent levels across the country change markedly.

10. One could argue that LHA rates should be more uniform across the country, so that claimants face some of the additional cost of choosing to live in higher-rent areas. But that would be an argument for weakening the link between LHA rates and local rents; it would not be an argument for replacing a link to current local rents with a link to historical ones, as this policy does. The policy does not achieve any move towards greater geographical uniformity compared with the current system: it will retain geographical variation in LHA rates just as now, but based on historical rather than contemporary differences in rent levels. If rents in high-rent areas happened to grow more rapidly than those in low-rent areas, uprating all LHA rates by the same factor (CPI inflation) rather than in line with local rents would stop further divergence in LHA rates that would otherwise have taken place. But the policy could also prevent convergence of LHA rates: if an expensive area experiences relatively low rent growth (but remains expensive), the effect of the change will actually be to strengthen the incentives of tenants to live in that area over cheaper areas with faster rent growth. Indeed, if the ranking of areas by their rent levels changes at all after 2012–13 – as it surely will – then in future there will be areas that have *higher* rent levels than other areas and yet have *lower* LHA rates.
11. The decision to set LHA rates each year at the *minimum* of the 30<sup>th</sup> percentile of local rents and last year's LHA rate uprated in line with CPI inflation could also have strange impacts, in that LHA levels would depend on the past *volatility* of real rents. For example, until April 2013 the LHA rate for people without children was £75 per week in both North Nottingham and West Pennine. Rents at the 30<sup>th</sup> percentile recently declined in North Nottingham, so its LHA rate from April was reduced to £69.23. In West Pennine, rents at the 30<sup>th</sup> percentile rose over the same period, and its LHA rate rose with CPI inflation, to £76.65 – 11% higher than North Nottingham's. Suppose that rents in both areas subsequently grow in real terms, but that North Nottingham's rents catch up with West Pennine's once more. LHA rates in both areas would rise in line with CPI inflation after 2013–14. The LHA rate in North Nottingham in (for example) 2050 would therefore be 11% lower than that in West Pennine despite rent levels being the same, purely because of short-run rent volatility more than 30 years previously.
12. As with the LHA cuts that were implemented in April 2011, the effect on rents, and therefore how much of the cut is passed on to landlords, is a key uncertainty. And as with the other LHA cuts, affected claimants are a low-income group, but the reform does strengthen work incentives. Regardless of these issues, however, this policy should be reconsidered because of the arbitrariness it creates within the housing benefit system.

## Cuts to housing benefit for working-age tenants 'under-occupying' social housing

13. This policy – described as a 'bedroom tax' by some and as the elimination of a 'spare room subsidy' by others – has many possible consequences but its actual effects are highly uncertain. It should be monitored closely.
14. The first stated objective is to encourage better use of the social housing stock. Clearly the policy introduces a financial disincentive to have more bedrooms than the government deems needed. The extent to which this results in less 'under-occupation' will depend upon whether and how tenants and social landlords respond:
  - If affected tenants are unable to find a suitable socially rented property with fewer bedrooms, they may instead move to the private sector. (A resulting claim under the LHA rules could be more or less expensive to the taxpayer than the original housing benefit claim.)
  - Affected tenants might take in a lodger in the extra bedroom.
  - Social landlords could increase efforts to identify overcrowded and under-occupied properties and facilitate home exchange.
  - Social landlords could allocate families to properties using different criteria. For example, if young couple tenants without children are currently given properties with more than one bedroom in expectation that they will shortly have children, this may be less likely in future (whether this change would constitute an improvement is not clear-cut, as there are costs to moving families around when circumstances change). If this were the primary response then only the flow of new tenancies would be affected, so the policy would take longer to have much effect on the extent of under-occupation.
  - Another longer-term response which could reduce the extent of under-occupation would be to build more smaller social properties (particularly, perhaps, one-bedroom properties for tenants without dependent children).
15. Notwithstanding the uncertainties about landlords' and tenants' responses, the scope to encourage better use of the housing stock is limited by the fact that the change applies to only a subset of social tenants: neither non-recipients of housing benefit nor pensioners are affected.
16. A second stated objective is to promote equity between private and social sector tenants. Since the housing benefit entitlements of private sector tenants are already limited by family size, one can understand this reasoning. On the other hand it might be argued that private and social sector tenants are not comparable in all relevant respects. It may be social landlords rather than social tenants who 'choose' which properties tenants live in, and therefore less fair to hold social tenants responsible for the size of their property than to do the same for private renters.

17. Finally, the government has cited the general desire to reduce housing benefit expenditure. The magnitude of any such reduction will depend on how many social tenants move into the private sector in response, the rent levels in those private sector properties, who they are displacing in those private sector properties, and who takes their place in the social home they leave behind. It is also important to note a potential trade-off between this objective and another: the greater the extent to which the policy encourages more efficient usage of social housing, the less it is likely to reduce expenditure on housing benefit. For example, if a group of under-occupying and overcrowded households effectively swap homes in response, then both groups of households will still be able to cover all their rent through housing benefit.
18. As with almost any cut to housing benefit, affected tenants will tend to have somewhat strengthened work incentives (there will be less housing benefit to lose if they enter work or increase their earnings).

## **Benefits cap**

19. The level of the benefits cap - £500 per week, or £350 for single people without dependent children - means that it essentially affects only families with large numbers of children and/or high housing costs who receive a lot of support for those costs. An estimated 73% of affected households contain at least three children and 49% are in Greater London (where rents are high).<sup>3</sup>
20. The implication is that the government considers the welfare system too generous to some out-of-work families who have high housing costs and/or large numbers of children. It would be better to deal with this perceived problem by changing the specific benefit rates responsible for it (for example, the amounts that families can claim towards their rent or for lots of children) than for the government to find the consequences of its own chosen benefit rates unacceptable - particularly when starting from scratch, as the government is with universal credit. If it has a view on the maximum reasonable entitlements for people with lots of children and/or high housing costs, then it should design universal credit (and in particular, the child and housing cost elements within it) to reflect that view. It is difficult to see what is gained from instead layering a cap on top of a system designed to allow higher payments.
21. The government has said that it hopes for two forms of behavioural response: families may move to cheaper accommodation to reduce their housing costs and/or may take up paid work because their out-of-work benefit entitlement will have been reduced. These are both plausible responses, although their magnitude cannot be predicted with much confidence.

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<sup>3</sup> DWP's Impact Assessment, July 2012 (<http://www.dwp.gov.uk/docs/benefit-cap-wr2011-ia.pdf>).

## Localisation and funding cut for council tax support

22. The new central government grants for council tax support (CTS) are based on 90% of what would otherwise have been spent on Council Tax Benefit (CTB) in each area. The protection of pensioners from these changes is very significant. A full pass-through of the funding cut to claimants of CTB would represent an average 19% cut in support for the English working-age population.<sup>4</sup> But of course there is no obligation for local authorities in England, or the devolved governments, to spend the amount of the new grant on CTS (they could spend more or less), and there is much variation in the choices being made (see below).
23. IFS researchers have analysed the options for designing CTS schemes for local authorities in England and the Welsh government.<sup>5</sup> There is, as ever, a trade-off between protecting those with the lowest incomes and maintaining incentives to work. In order to save the full 10% by which funding is being cut, councils must either reduce support for those previously entitled to maximum CTB – those on the lowest incomes – or significantly weaken work incentives via much more aggressive means-testing.
24. The stated aims of localisation are to allow support to reflect local priorities, and to strengthen incentives to promote local employment and growth. It could also reduce incentives to increase council tax or facilitate low-value housing development or encourage take-up of support, and increase incentives to discourage low-income families from living in the area and cut down on fraud and overpayments. The overall pattern of change in incentives is complex and councils' likely responses are unknown.
25. The devolved governments decided that the previous systems of support for local property tax would be retained in 2013–14. By implication, they need to find savings elsewhere equivalent to about 10% of the cost of providing that support, or set higher property tax rates than they would otherwise have done. In contrast, research by the New Policy Institute<sup>6</sup> shows that only 18% of English local authorities have maintained the previous system. The others have introduced a wide range of changes, including minimum council tax payments, reductions to or removal of Second Adult Rebates, caps on entitlements to the amount available for a band D property, reductions in the amounts of financial assets claimants can have, changes to backdating rules, counting other benefits as income in the means test, and changing the withdrawal rate to means-test more aggressively. The variation in council tax rebate schemes that is clearly developing might be welcomed on the basis that it could reflect variation in local needs and priorities. But it also reduces transparency and increases complexity and bureaucracy.

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<sup>4</sup> S. Adam and J. Browne, *Reforming Council Tax Benefit*, IFS Commentary 123, 2012 (<http://www.ifs.org.uk/publications/6183>).

<sup>5</sup> Ibid and S. Adam and J. Browne, *Reforming Council Tax Benefit: Options for Wales*, IFS Briefing Note 129, 2012 (<http://www.ifs.org.uk/publications/6204>).

<sup>6</sup> <http://counciltaxsupport.org/the-story-so-far/>.

26. It is difficult to think of reasons why the government's original plan to integrate CTB into universal credit was inferior to the current policy (with, if wished, a centralised cut to reduce spending). The main aims of universal credit were to simplify the benefits system and rationalise work incentives by removing the extremely weak incentives that can arise when multiple benefits are withdrawn over the same range of income. Keeping council tax support separate from universal credit (let alone allowing it to vary across the country) increases the complexity of the system and could lead to the reintroduction of the extremely high effective tax rates universal credit was supposed to eliminate. The extent to which this will happen will depend on how CTS schemes interact with universal credit (e.g. whether universal credit counts as income in CTS means tests). Devolved governments and local authorities, which have no experience in designing welfare systems, will have to deal with these difficult issues.