

# Support with Housing Costs

Developing a simplified  
and sustainable system



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## **Developing a simplified and sustainable system**

Consultation at St George's House, Windsor Castle  
22<sup>nd</sup> – 24<sup>th</sup> June 2010

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# Foreword

The provision of support with housing costs, particularly Housing Benefit, has been the subject of renewed political and popular interest. Proposals for major changes to Housing Benefit have been announced since the coalition government took office in May 2010, the first of which were announced in the emergency budget of June 2010. This was closely followed by a major consultation on welfare reform from the Department for Work and Pensions which is intended to form the foundation of new legislation. The Secretary of State, Iain Duncan Smith, has described this as a “once-in-a-generation opportunity”<sup>1</sup> to tackle some of the issues that others have not been willing or able to tackle.

The emergency budget on 22<sup>nd</sup> June 2010 coincided with the first day of a Consultation at St George’s House, Windsor Castle on support with housing costs, coordinated by BSHF and chaired by Lord Richard Best. The Consultation had been organised long before the announcement of the emergency budget, as the need for greater attention to the issue was one of the findings of a BSHF Consultation in 2009 on the future of the UK’s housing system.<sup>2</sup> As an independent housing research charity, BSHF saw the need for a systematic review that drew together a wide range of stakeholders from across the housing sector to look at both Housing Benefit and the broader context of support with housing costs.

Discussions at the Consultation have already contributed to a number of outputs which are all freely available. These include:

- *Housing Benefit and the Emergency Budget of June 2010*,<sup>3</sup>
- *BSHF Submission to Spending Review 2010*,<sup>4</sup>
- Submissions to the Work and Pensions Select Committee’s inquiry into the impact of the changes to Housing Benefit, the Social Security Advisory Committee’s consultation on the proposals, and the Department for Work and Pensions’ consultation on *21<sup>st</sup> Century Welfare*.<sup>5</sup>

This report offers a wider, structural view of support with housing costs. It comprises the following sections:

- **Historic development of support with housing costs.** This section provides background on how the current system of support with housing costs has developed.
- **The current system of support.** A summary of the current system of support with housing costs. It focuses on the three main areas of support, which are Housing Benefit, provision of social housing at below market rents and favourable taxation of owner occupation.
- **A coherent vision for support with housing costs.** This section looks at basic objectives for a system of support.
- **Options for reform.** This section explores both short and long term options for reform of different types of support with housing costs.

BSHF would like to thank everyone who has been involved in the Consultation process. Support with housing costs is a very important issue for the housing system, the economy and the wider society. It is our hope that the Consultation and this report can play a part in developing sustainable financial support to ensure that everyone in the UK has access to decent and affordable housing.

# Executive summary

**Government support with housing costs** has formed a part of wider social security systems in the UK for around the last one hundred years. Since these early interventions, direct support has taken different forms and is currently under review. These different types of support have included:

- Interventions before the First World War to improve public health;
- Major programmes of building social housing, particularly in the interwar years and 1950s;
- Policies that promoted homeownership such as the Right to Buy and Mortgage Interest Tax Relief;
- A major shift from capital subsidies (such as house building) to revenue subsidies (such as Housing Benefit) between 1975 and 2000;
- Recent proposals by the coalition government to reform Housing Benefit.

**The current system of support with housing costs** is dominated by three types of support:

- means-tested Housing Benefit payable to households who rent their accommodation;
- provision of social housing at below market rents;
- and favourable taxation of owner occupiers.

Housing Benefit, particularly, has been criticised because of perceived problems including:

- Difficulty in controlling costs;
- Complexity;
- Problems with variation between localities and between tenures;
- Lack of clarity of purpose.

These difficulties highlight the need for a coherent vision for support with housing costs.

- The goal of achieving decent and affordable housing for all must be used as the direction of travel for both short and long term changes to support with housing costs.

- In order to safeguard the provision of decent and affordable housing for future generations it is important that support with housing costs is politically and financially sustainable in the long term.
- Support with housing costs needs to form part of wider housing and economic policies that are coherent and complementary.
- Support with housing costs should do no harm to the wider housing system, including not increasing homelessness.

A coherent vision is vital in considering both short and long term **options for reform** of support with housing costs. Three key areas for action are:

1. **Reforming Housing Benefit.** The coalition government intends to make major changes to Housing Benefit. Successful reform of Housing Benefit should be based on simplification of both its purpose and operation. Reform of Housing Benefit is needed to provide a clearer purpose and a narrower focus on maintaining residual incomes. These reforms should:
  - respond to how people now live;
  - be “roughly right rather than exactly wrong”;
  - consider a different system for pensioners;
  - remove the current variation in a payment depending on when the original claim was made;
  - remove the differential treatment of younger people;
  - ensure that they do not result in an increase in homelessness.

There is still a clear need for a housing allowance that reflects local variation in rents. This narrower focus for Housing Benefit will work only if it sits within coherent housing and economic policies that address the root causes of the increase in Housing Benefit costs.

A key proposal of the coalition government is to move towards a single universal credit benefits system. The points listed above could be applied equally to the housing component of a universal credit as to a reformed Housing Benefit.

2. **Increasing the supply of housing.** Demand-side subsidies such as Housing Benefit are not enough on their own and a sustainable approach must include policies that ensure that the cost of housing becomes affordable for more people. These can include the subsidy of social rented housing, but also wider policies that seek to increase the supply of market housing. Since the early 1990s successive governments have relied on Housing Benefit to

“take the strain” of housing policy. It may now be time for supply side ‘bricks and mortar’ subsidies to take more of the strain to ensure that housing support is financially sustainable in the long term. There has been a particular problem producing sufficient social rented housing over the last 30 years, since local authority housing development dropped to close to zero and housing association development failed to replace that lost stream of development. Last year BSHF published *The Future of Housing*, which highlighted almost 40 possible options that might contribute to an increase in housing supply.

3. **Adopting a cross tenure approach to housing support.** A coherent approach to support with housing costs will need to deal with the relationships between different tenures. A universal housing allowance which provides support with housing costs regardless of tenure has long been discussed as a possible solution to the differences in tenures. However, in the current economic circumstances, and especially given the current differences between the tenures, it may be more effective to look at other ways of balancing the support provided in different tenures. An alternative proposal that merits close attention is the Sustainable Home Ownership Partnership (SHOP).

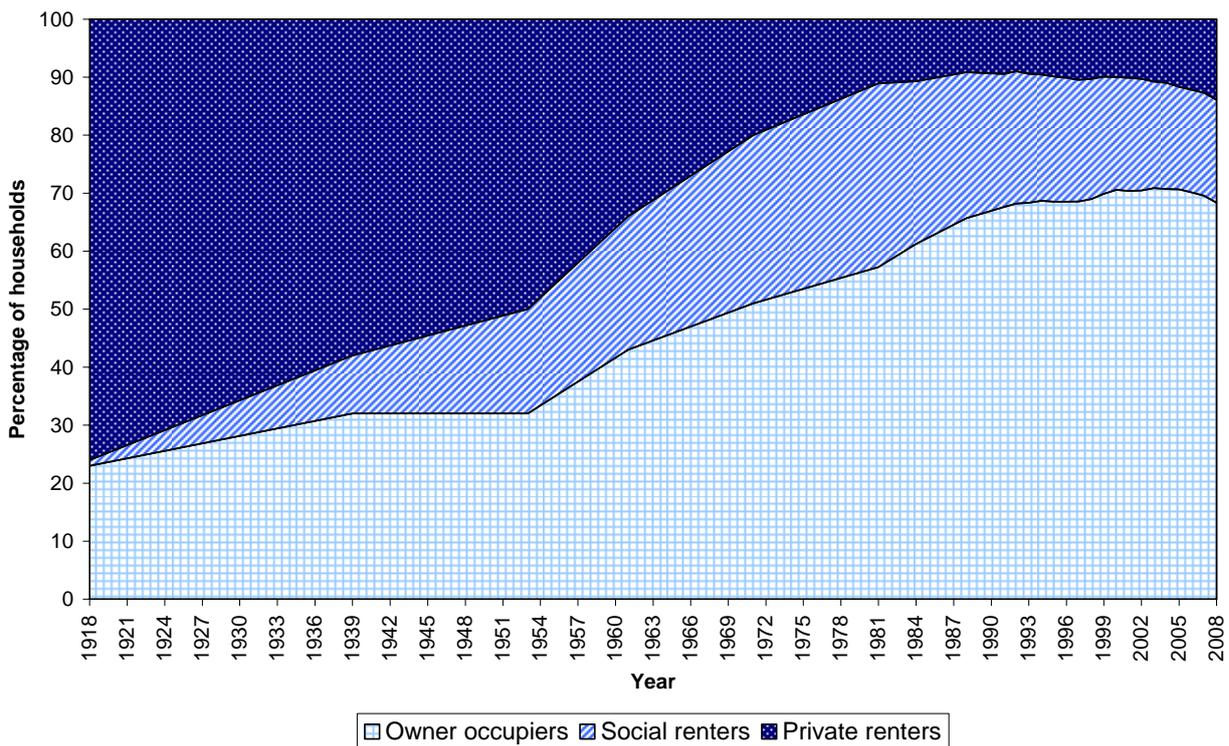
Favourable taxation of owner occupation represents a major subsidy to households in this tenure. This cannot be justified in a period when the government is seeking to cut the budget deficit quickly. Steps should be taken to neutralise the advantageous tax treatment of owner occupation, relative to private renting. This could take the form of the reintroduction of Schedule A taxation on imputed rents combined with a restructuring of property and land taxes, with the effect of taxing capital value on an annual, rather than transactional, basis.

With the private rented sector growing by one million households between 2005 and 2009, it is vital to ensure that it offers decent and affordable housing. Ensuring minimum standards is a key aspect of improving the private rented sector.

# Historic development of support with housing costs

Government support with housing costs has formed a part of wider social security systems in the UK for around the last one hundred years. Since these early interventions, direct support has taken different forms<sup>6,7</sup> and is currently under review. This support is closely linked to housing tenure, which, as Figure 1 shows for England, has changed profoundly over this period;<sup>8</sup> the changes in the tenure mix have both influenced and been influenced by the types of support that have been given at different times. The changes in tenure have been similarly profound in the other parts of the UK, although not always following exactly the same path as England.<sup>9</sup>

**Figure 1: Tenure trend, percentage of households by tenure, England, 1918 to 2008<sup>10</sup>**



At the **start of the last century** around 90 per cent of the UK population lived in the private rented sector. Government involvement in housing prior to 1918 was driven by concerns about the impact of poor housing on the health and morality of society. Interventions during this period aimed to promote a healthy labour force and the wider public health of the UK through the reduction in

'insanitary conditions' rather than provide direct financial support with housing costs.

A major public and private housebuilding programme took place in the **interwar years** to provide 'Homes fit for Heroes'. The development of council housing, subsidised accommodation developed by local authorities, expanded rapidly and an average of over 50,000 dwellings were built each year in the interwar years. From the 1930s onward, recipients of social assistance benefits were entitled to help with housing costs.<sup>11</sup> Local authorities were able to provide rent rebates to tenants and the private rented sector was subject to rental controls that limited increases in rental prices.

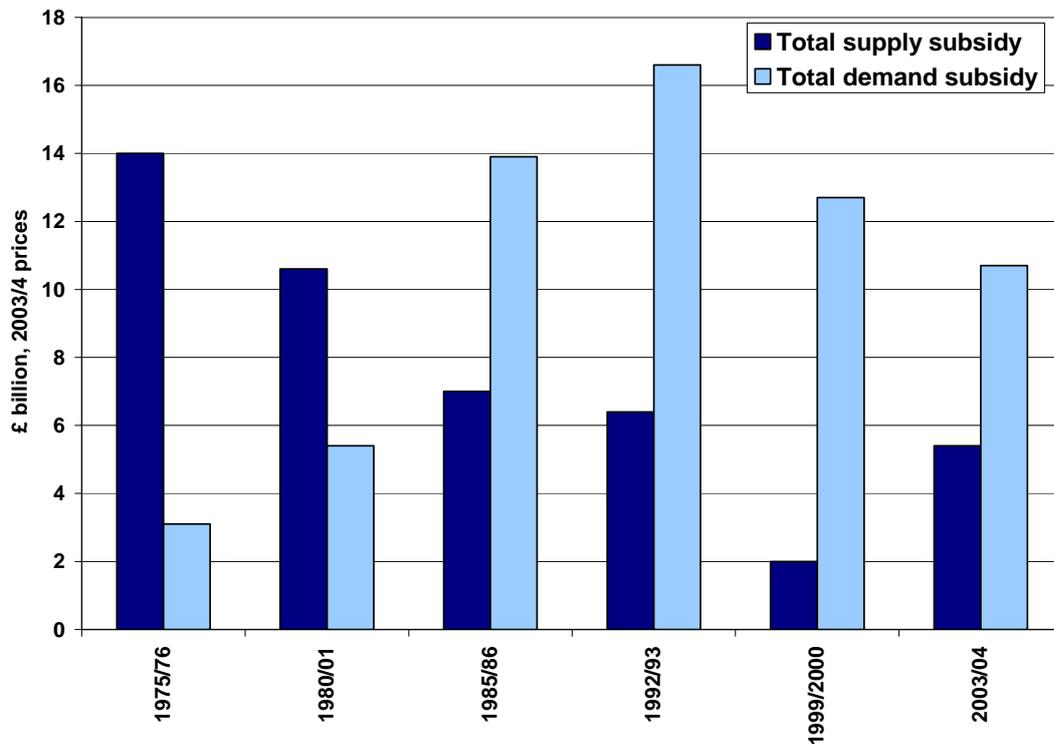
Tackling the five 'Giant Evils' outlined by Beveridge<sup>12</sup> formed the basis for the development of the welfare state **after the Second World War**. Government intervention in the provision of adequate housing was to be the response to the social evil of squalor. Local authorities continued to play a major role in building new dwellings to replace those lost during the war and to eliminate slum housing. More generous government subsidies were designed to encourage the provision of housing for low income households.

Restructuring of housing subsidies – from capital subsidies given to social housing providers to build houses, to revenue subsidies for individuals – was one of the major housing policy changes **between 1975 and 2000**.<sup>13</sup> Housing Benefit was established in 1982 and formed the core of this shift towards individual subsidies based on incomes. Capital subsidies for new social housing reduced dramatically and building by local authorities almost entirely ceased by the late 1980s. Building by housing associations has increased since then but has never reached the volumes previously achieved by local authorities. This shift to revenue subsidies took place alongside the Right to Buy policy, introduced in 1980, which gave social tenants the opportunity to buy the property they rented at a discounted price.

The balance between supply side and demand side subsidies has changed significantly over recent decades. (The supply and demand categorisation is used by some authors in place of capital and revenue subsidy classifications. Capital subsidies are supply side, allowing landlords to supply more or better accommodation than they otherwise would be able to. Most revenue subsidies are demand side, giving consumers (purchasers and renters) of housing more resources to spend on housing. Local authority revenue subsidies, however, are classified as supply side, because they support local authority housing departments to supply more accommodation than they otherwise could at the rent levels charged.) As shown in Figure 2 below, in 1975 more than 85 per cent of housing subsidies were supply-side, but by 2000 more than 85 per cent

were demand-side. This trend has somewhat reversed more recently, but has stabilised at around 65 per cent of the subsidy going on demand-side since 2004.

**Figure 2: Housing subsidy (constant prices), England, selected years between 1975/76 and 2003/04<sup>14</sup>**



Tax relief for mortgage interest is considered to have its origins in the early 1800s but the value of this benefit grew considerably in the 1960s as both house prices and interest rates increased. It became a “major driver of homeownership [particularly] in the last quarter of the twentieth century”.<sup>15</sup> By 1990/91 Mortgage Interest Tax Relief cost £7.6 billion and accounted for over 40 per cent of all support with housing costs.<sup>16</sup> It came under increasing criticism as a counterproductive benefit that increased demand and, therefore, house prices.<sup>17</sup> The phased abolition of this tax relief took place during the 1990s and it was finally removed in 2000.

**Significant reform of Housing Benefit was undertaken in 2008** with the introduction of the Local Housing Allowance (LHA). This was designed to provide “a fairer way of calculating Housing Benefit for tenants who live in private rented accommodation”.<sup>18</sup> Local Housing Allowance uses local rent levels to cap the amount that can be paid in Housing Benefit and encourages the direct payment of Housing Benefit to tenants. The Local Housing Allowance

reforms were designed to promote choice and responsibility, improve administration and reduce barriers to work.

The Department for Work and Pensions conducted a consultation on Housing Benefit reforms which ended in February 2010. It stated that “we want Housing Benefit to support independence and aspiration; we need it to be fair, affordable and sustainable”<sup>19</sup> implying the need to balance satisfactory housing outcomes for those supported with a reasonable cost to public expenditure. It proposed changes to improve work incentives, exclude the highest rents and set out a “long-term aspiration to move towards greater integration of Housing Benefit into the wider tax and benefit regimes”.<sup>20</sup>

The **coalition government that came to power in the UK in May 2010** has made welfare reform one of its key objectives. It has sought to explicitly link jobs and welfare saying that “the Government believes that we need to encourage responsibility and fairness in the welfare system. That means providing help for those who cannot work, training and targeted support for those looking for work, but sanctions for those who turn down reasonable offers of work or training”.<sup>21</sup>

The emergency budget of June 2010 highlighted that the amount spent on Housing Benefit in 2008/09 was approximately £17.2 billion<sup>22</sup> and increased to nearly £20 billion in 2009/10.<sup>23</sup> Largely in an effort to control these costs, the budget introduced several measures in relation to Housing Benefit.<sup>24</sup> BSHF has provided detailed analysis of these measures.<sup>25</sup> The measures introduced are:

- **LHA rates set at the 30<sup>th</sup> percentile.** From October 2011, Local Housing Allowance rates will be set at the 30<sup>th</sup> percentile of local (market) rents. At present they are set at the median (i.e. 50<sup>th</sup> percentile) of local market rents.
- **LHA rate caps.** 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.
- **Index linking of LHA.** From 2013/14, Local Housing Allowance rates will be updated in line with the consumer price index (CPI). Currently LHA rates are recalculated monthly based on actual market rents in the area. The CPI has generally risen slower than rents so over time LHA will cover a smaller proportion of rent. Between 1997 and 2007, CPI inflation averaged 2 per cent annually,<sup>26</sup> whereas rent inflation averaged 5 per cent.<sup>27</sup> Indexing also

means that rent levels will be based on 2013 rent levels and will not reflect subsequent changes in regional and local variation.

- **Non-dependant deductions to increase.** Deductions for non-dependants (such as grown-up children living with their parents) will be uprated in April 2011 on the basis of prices. This will reverse the freeze in these rates since 2001/02.<sup>28</sup>
- **Social sector benefits to match household size.** From April 2013, housing entitlements for working age people in the social sector will reflect family size (i.e. the level of eligible rent on which households will be entitled to claim Housing Benefit will be related to the size of the household, not the size of the home). It is estimated that around 11 per cent of households in the social rented sector are considered to be under occupying their accommodation.<sup>29</sup>
- **Housing Benefit to be cut after 12 months claiming Jobseeker's Allowance.** Housing Benefit awards will be reduced to 90 per cent of the initial award (i.e. 90 per cent of their normal 'full' entitlement) after 12 months for claimants receiving Jobseeker's Allowance. This will be introduced in April 2013.
- **Entitlement to space for a carer.** From April 2011, Housing Benefit claimants with a disability and a non-resident carer will be entitled to funding for an extra bedroom.
- **Discretionary Housing Payment fund increased.** The government contribution to Discretionary Housing Payments will be increased by £10 million in 2011/12 and £40 million in each year from 2012/13.

A Welfare Reform Bill was announced in the Queen's Speech of May 2010. The first details of the likely shape of these reforms began to emerge in speeches by the Secretary of State for Work and Pensions, Iain Duncan Smith. He stated his desire to make the welfare system "simpler and more transparent so that work always pays".<sup>30</sup> Duncan Smith is the founder of the Centre for Social Justice, a think tank that published detailed plans for welfare reform titled *Dynamic Benefits*.<sup>31</sup> This report provided the foundation for welfare reform proposals outlined in a Department for Work and Pensions consultation on *21<sup>st</sup> Century Welfare*,<sup>32</sup> which was published on 30<sup>th</sup> July 2010. A key element of the proposals is the simplification of the benefits system through the adoption of a single universal credit, replacing most or all of the current benefits.

# The current system of support

The current housing support system was described by the Hills Review which stated that: “In principle, there is a wide range of different forms that housing support can take, of which provision of housing by not-for-profit landlords at sub-market rents is only one. However, the system ... is dominated by just three:

- means-tested Housing Benefit;
- provision of social housing at below-market rents;
- and favourable taxation of owner-occupiers.”<sup>33</sup>

The Hills Review refers elsewhere to Income Support for Mortgage Interest (ISMI), now called Support for Mortgage Interest (SMI); it is excluded from the list of dominant support as the overall bill for SMI is significantly smaller than the other forms of support.

Although the remit of the Hills Review related to England only, the broad description of the types of housing support holds true across other parts of the UK. In 2007/08 the Housing Benefit bill was £15.7 billion,<sup>34</sup> owner occupier tax advantages totalled £23.7 billion<sup>35</sup> and capital investment in social housing was about £8.4 billion.<sup>36</sup> Together, several smaller forms of support add about a further £3.4 billion, creating a total cost of housing support of £51.2 billion.

At present the UK’s system for the ‘active’ provision of support with housing costs (as distinct from the support provided by foregoing tax income from owner occupiers, which could be viewed as relatively passive) is a hybrid of capital and revenue support, with a greater emphasis on revenue. On the capital side, housing is provided generally by local authorities and housing associations, subsidised by government grant (through the Homes and Communities Agency in England, and the Scottish Government, Welsh Assembly Government and Northern Ireland Housing Executive in their respective countries). On the revenue side, the principal support is through Housing Benefit, which is administered by local authorities and paid to tenants in both the social rented and private rented sectors based on income criteria (up to a limited amount).

There is a variety of other types of support with housing costs that can be provided. These include grants and concessional loans (e.g. for home improvements), shared ownership and shared equity schemes (which support part ownership through subsidised loans or rents) or even simply giving

ownership of housing to tenants for free (as occurred in some Eastern European countries after the fall of Communist governments).<sup>37</sup>

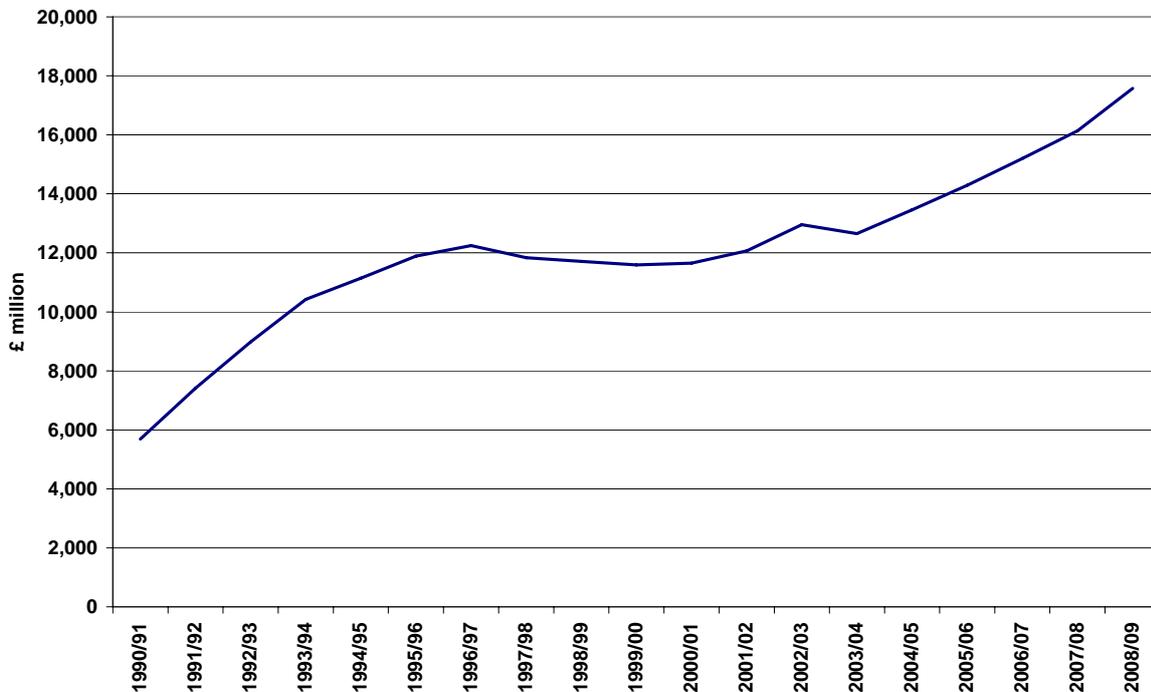
The three main areas of financial support are described in greater detail below. Despite its close links to Housing Benefit, Council Tax Benefit is not strictly a form of support with housing costs, so for simplicity it is not addressed in detail in this report.

## Housing Benefit

Housing Benefit is administered by local authorities, as opposed to central government, and is subdivided into rent rebates and rent allowances. “Rent rebates” refers to Housing Benefit paid to local authority tenants and “rent allowances” to those paid to tenants of housing associations and private landlords. Housing Benefit is not available to owner occupiers.

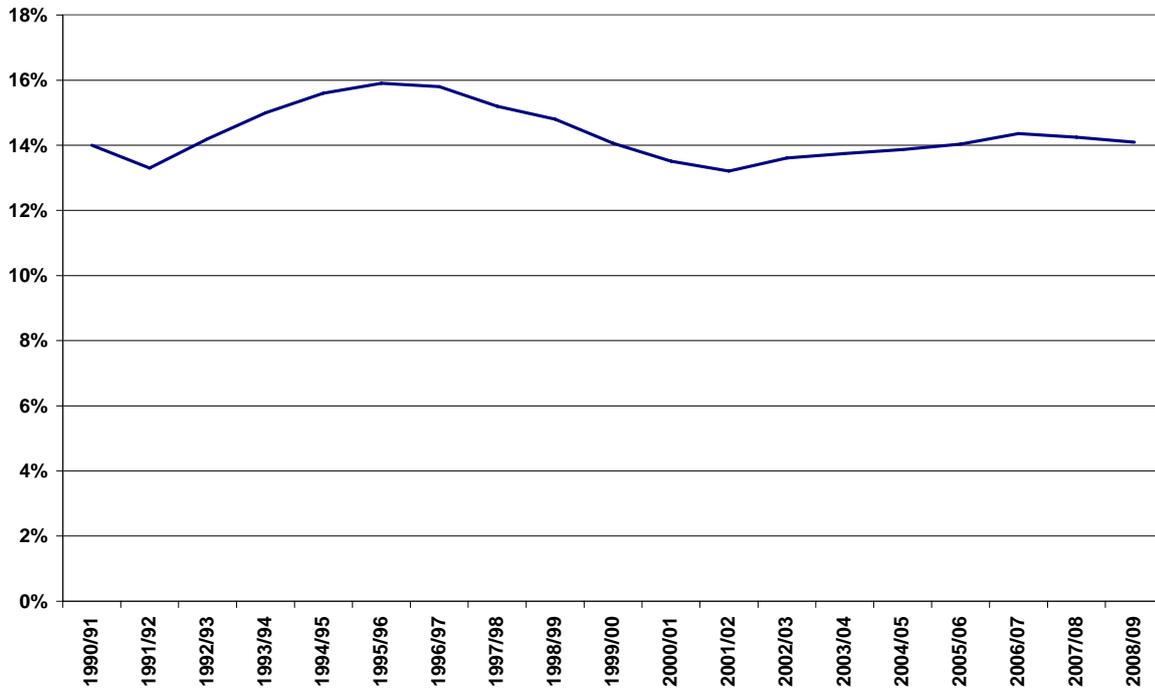
In April 2010, 4,746,000 households received Housing Benefit,<sup>38</sup> at a total cost of over £20 billion in 2009/10.<sup>39</sup> Total expenditure on Housing Benefit has grown consistently since 2003/04. Between 1995/96 and 2003/04, total expenditure on Housing Benefit remained stable at around £12 billion. Figure 3 (below) outlines the historic changes in total Housing Benefit expenditure.

**Figure 3: Housing Benefit expenditure, Great Britain<sup>40</sup>**



The cost of Housing Benefit as a proportion of all benefits and tax credits has remained relatively stable at around 14 per cent of the total for the last twenty years (see Figure 4 below). This suggests that the increase in total Housing Benefit expenditure reflects wider changes in benefits and tax credits.

**Figure 4: Housing Benefit as a percentage of total benefits and tax credits, Great Britain<sup>41</sup>**



Observers from across both the housing sector and the political spectrum have expressed criticisms and concerns about Housing Benefit. These criticisms and concerns can be summarised in four major categories:

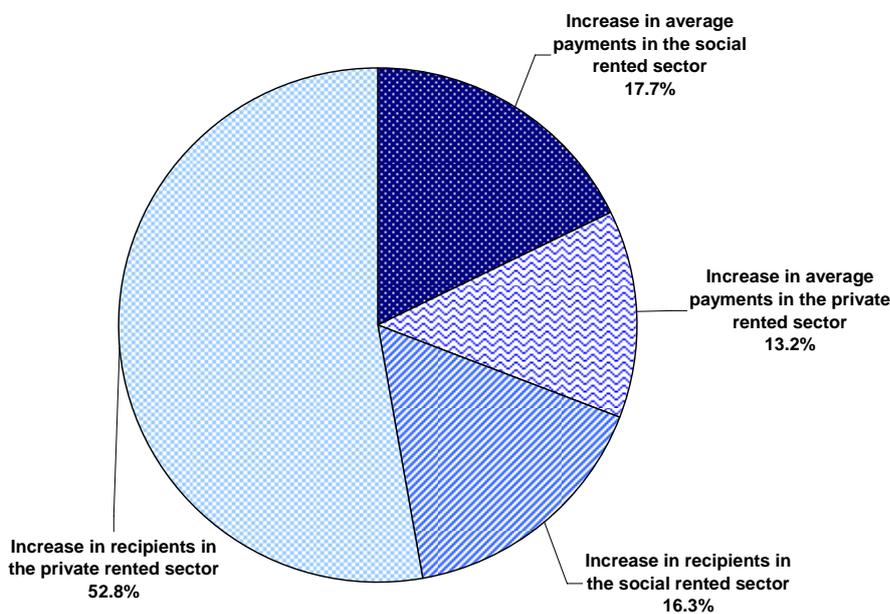
- Difficulty in controlling costs;
- Complexity;
- Problems with variation between localities and between tenures;
- Lack of clarity of purpose.

### Difficulty in controlling costs

It has already been noted that total expenditure on Housing Benefit has increased in recent years and that this is in line with wider increases in expenditure on benefits and tax credits. Prior to the recession, the bulk of this increase in Housing Benefit expenditure was due to increases in rents. In the decade to 2006, for example, the number of recipients in the private rented sector fell by 21 per cent from 1,066,000 to 838,000, while their average

weekly Housing Benefit increased by 47 per cent, from £58 to £85.<sup>42</sup> More recently, however, the majority of the increase has been due to the increasing number of recipients (Figure 5). Between November 2008 and April 2010 approximately 70 per cent of the increase in total Housing Benefit expenditure was due to the growth in claimant numbers. Almost all of this growth (approximately 99 per cent)<sup>43</sup> was in working age claimants, suggesting that the increase in claimants was linked to falling levels of employment.

**Figure 5: Proportion of the increase in the Housing Benefit bill due to different factors, November 2008 to April 2010<sup>44</sup>**



A significant proportion of the increase in the cost of Housing Benefit has been due to government policies, acting to restructure the housing system.

The movement away from local authority housing provision to that of Housing Associations was encouraged through, for example, the operation of the Decent Homes programme, which made available additional funds for homes to be brought up to the Decent Homes Standard if a local authority transferred its stock to a housing association. Given that rents in housing association properties are on average £48 per month higher than in local authority properties,<sup>45</sup> the transfer of large numbers of claimants to housing associations naturally created an upward pressure on Housing Benefit expenditure.

A policy of rent convergence has been pursued since 2001, whereby those social rented landlords charging rents lower than average for the social rented sector in their area were encouraged to increase their rents toward the higher levels.

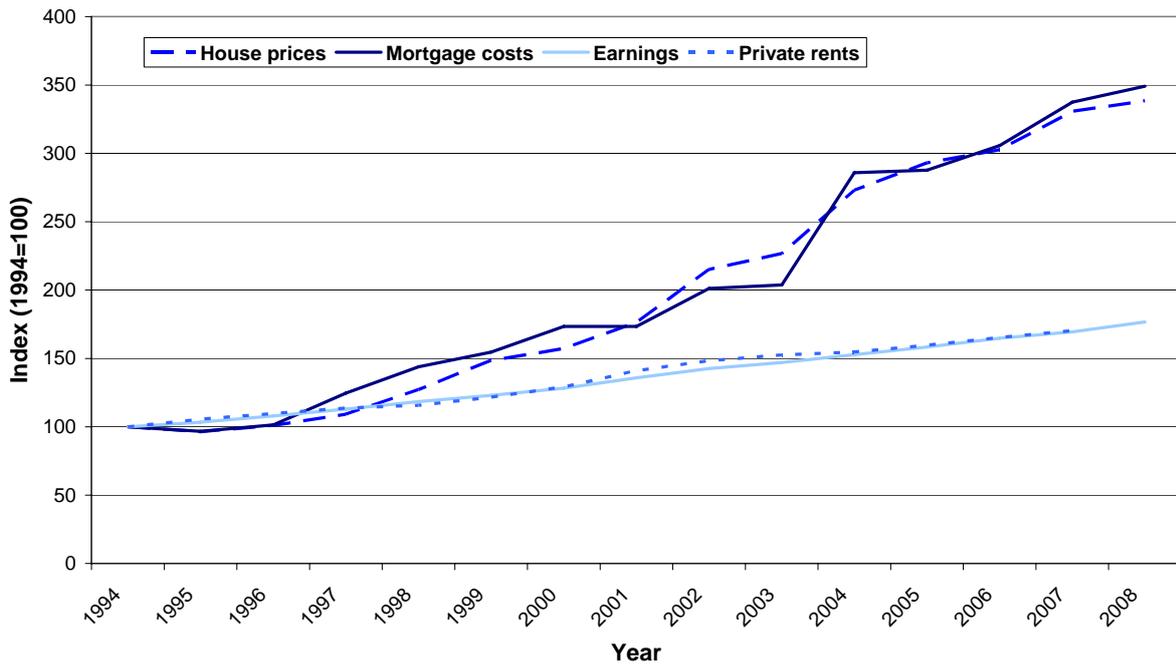
Generally this has meant local authority rents increasing to converge with those of housing associations. Again, this policy acts to create an upward pressure on the Housing Benefit expenditure.

The growth of the private rented sector, has also caused a large increase in the Housing Benefit expenditure, as rents in this sector are on average almost twice as high as for local authority accommodation in the social rented sector.

Therefore, government policies and changes in the housing system have increased the number of claimants in the two more expensive sectors (private renting and housing associations) while also increasing local authority rents. This has inevitably increased expenditure on Housing Benefit.

It is important to note that Housing Benefit is linked to rent inflation rather than general inflation. Rental prices tend to follow wage inflation therefore Housing Benefit expenditure may increase faster over time than other benefits (Figure 6).

**Figure 6: House prices, mortgage costs, rents and earnings compared<sup>46</sup>**



## Complexity

Housing Benefit has consistently been criticised for being too complex. It is a complex benefit, with links to other benefits and tax credits, different rules for private and social tenants and for in-work and out-of-work claimants, and has earlier versions and entitlements running in parallel.

The Department for Work and Pensions issues four volumes of guidance running to over 1,200 pages to local authorities in order to help them administer Housing Benefit and Council Tax Benefit.<sup>47,48</sup> The current complexity of the system is intended to allow benefit levels to be closely matched to the individual circumstances of a household. However, this complexity has been criticised for leading to a number of problems.

The first, and most commonly cited, criticism is that Housing Benefit acts as a **work disincentive**. The marginal deduction rate for those receiving tax credits, Housing Benefit and Council Tax Benefit can be as high as 95.95 per cent.<sup>49</sup> This means that a claimant would get less than five pence of every extra pound that they earned by moving into work. That is before any additional costs of working, such as clothing and travel are taken into account. The system is perceived as giving with one hand, only to take away with the other.<sup>50</sup>

The complexity of the rules and guidance leads to a second problem: **administrative difficulties**. The average processing time for new Housing Benefit applications is now 23 days.<sup>51</sup> This represents a significant improvement but the average conceals many applications that take much longer. Long processing times create difficulties for both claimants and landlords. There is also significant variation in the average processing time for new claims varies considerably, from eight days in Brentwood to 48 days in Harringey.<sup>52</sup>

The third problem is perceived to be **fraud and error**. Estimates of fraud and error vary and face significant methodological difficulties. One recent piece of evidence from the Department for Work and Pensions suggests that payment accuracy for Housing Benefit is 98 per cent.<sup>53</sup> Around 4.4 per cent, or £820m, of Housing Benefit expenditure is estimated to have been overpaid due to fraud or error (compared with 2.2 per cent of total benefit expenditure).<sup>54</sup>

The failure of Housing Benefit to reflect modern **employment and relationship structures** is a fourth criticism of its complexity. The increase in flexible and short term working patterns means that there is major variation in the income of mainly low paid and marginal workers. Changing employment patterns have led to many people on low incomes moving regularly between low paid

employment, self employment and unemployment.<sup>55</sup> This makes it very difficult to calculate the correct level of benefit that they are entitled to, particularly given the time taken to process changes to Housing Benefit. There is also a trend towards more fluid family structures that the benefit system finds difficult to classify and keep track of. This leads critics to suggest that Housing Benefit is ill-suited to modern patterns of lifestyles.

A fifth criticism of the complexity of Housing Benefit relates to **take up rates**. Estimated take up of Housing Benefit was between 77 and 86 per cent for 2008/09. The number of people that were entitled to, but not receiving, Housing Benefit was between 680,000 and 1,180,000.<sup>56</sup> Take up varies by tenure, household type and employment status. For example, the take up rate by case load for couples of working age with children is estimated to be between 58 and 70 per cent.<sup>57</sup>

The low take up of Housing Benefit amongst people in employment may compound the work disincentives described above. It is estimated that between 38 and 51 per cent of those in employment who are entitled to claim Housing Benefit do so, compared to 90 to 96 per cent of those not in employment.<sup>58</sup> This may be contributing to the perception that claimants will be worse off if they start work. Under-claiming may be due to people in low paid work not being aware of their eligibility to claim the benefit. The complexity of the system also creates real confusion and instability for people on low incomes; this is important as the incidence of people moving repeatedly between low paid jobs and unemployment has increased by 60 per cent since 2006.<sup>59</sup>

## Variation between localities and tenures

Going back as far as the Beveridge Report of 1942<sup>60</sup> the issue of “Benefit Rates and the Problem of Rent” has been identified as a significant concern in the design of social welfare systems. **Rents vary substantially around the country** and are generally the largest item of expenditure for households. The current LHA rate for a three-bedroom home in Central London is £700 per week, compared with £92.31 per week for a similar property in Blaenau Gwent.

The level of regional variation in prices is reflected in the **regional variation in the proportion of households that receive Housing Benefit**. This ranges from 14 per cent in the South East to 24 per cent in London (see Figure 7). At a local authority level the variation is even greater ranging from six per cent in Wokingham to 44 per cent in the London Borough of Hackney (see Figure 8).

Figure 7: Housing Benefit recipients as percentage of households, November 2009<sup>61</sup>

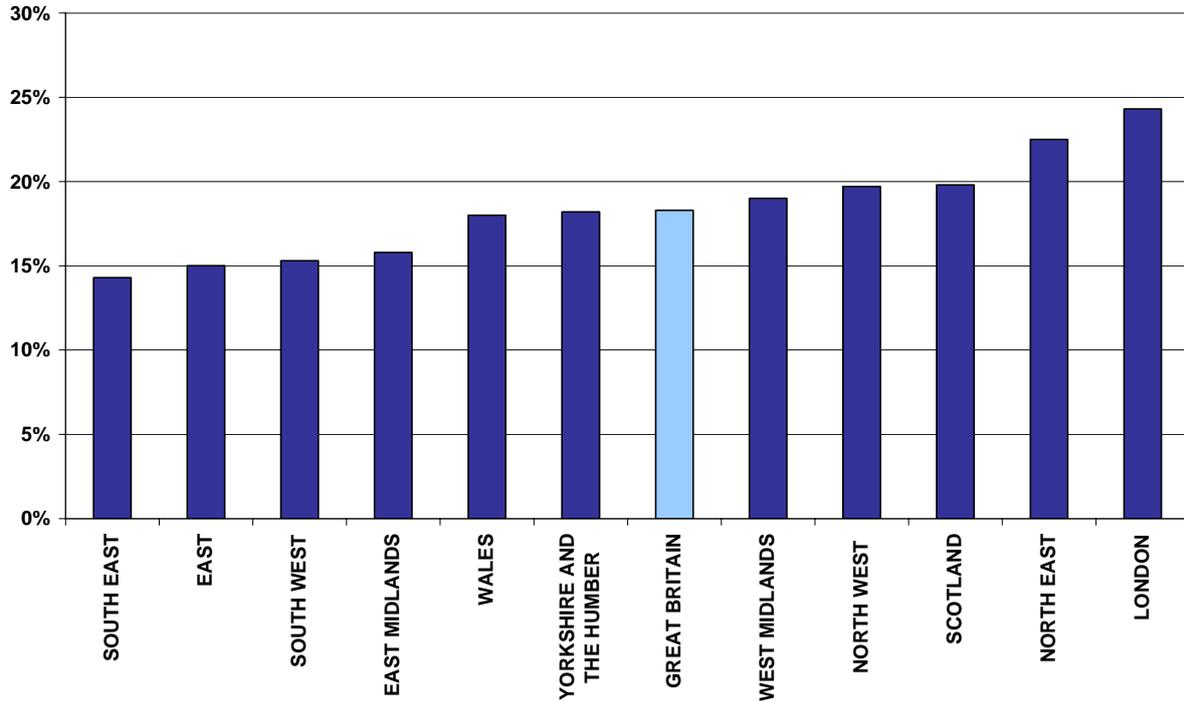
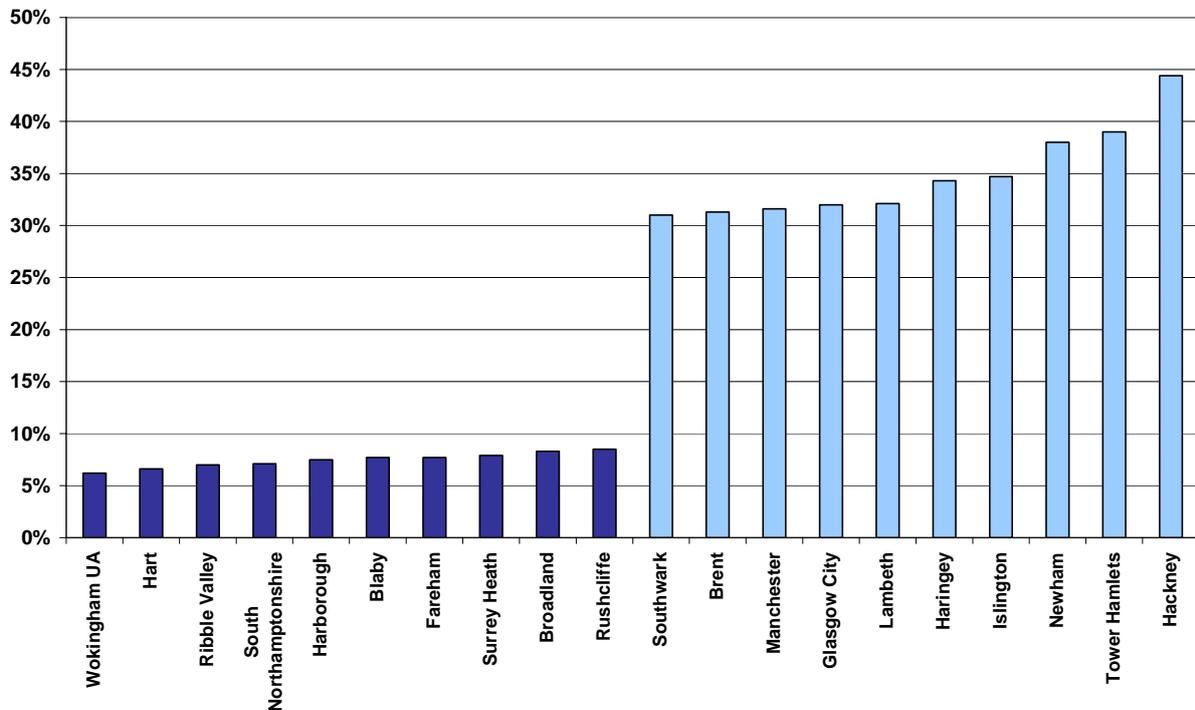
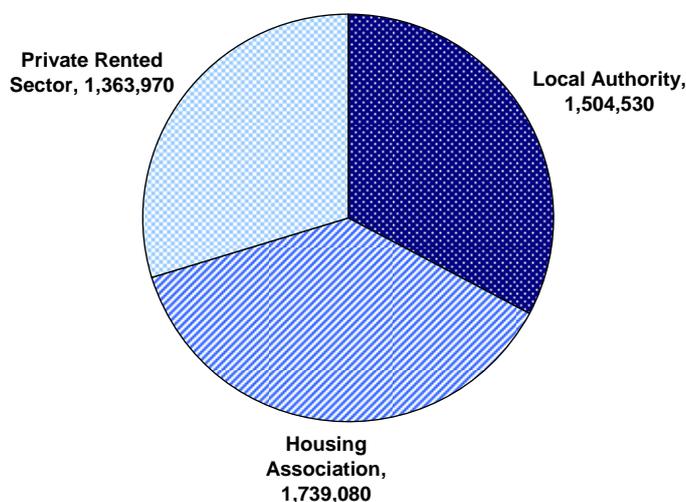


Figure 8: Ten local authorities with lowest and highest caseloads, Housing Benefit recipients as percentage of households, November 2009<sup>62</sup>



There are important differences in Housing Benefit between tenures. Over two thirds of Housing Benefit recipients are social renters, with the remaining 30 per cent renting in the private sector (see Figure 9). The social renters are split relatively evenly between local authority landlords (33 per cent of all recipients) and housing associations (37 per cent of all recipients). In comparison, of the total households that were renting, 40 per cent of dwellings were privately rented, 32 per cent were rented from local authorities and 28 per cent were renting from housing associations.<sup>63</sup>

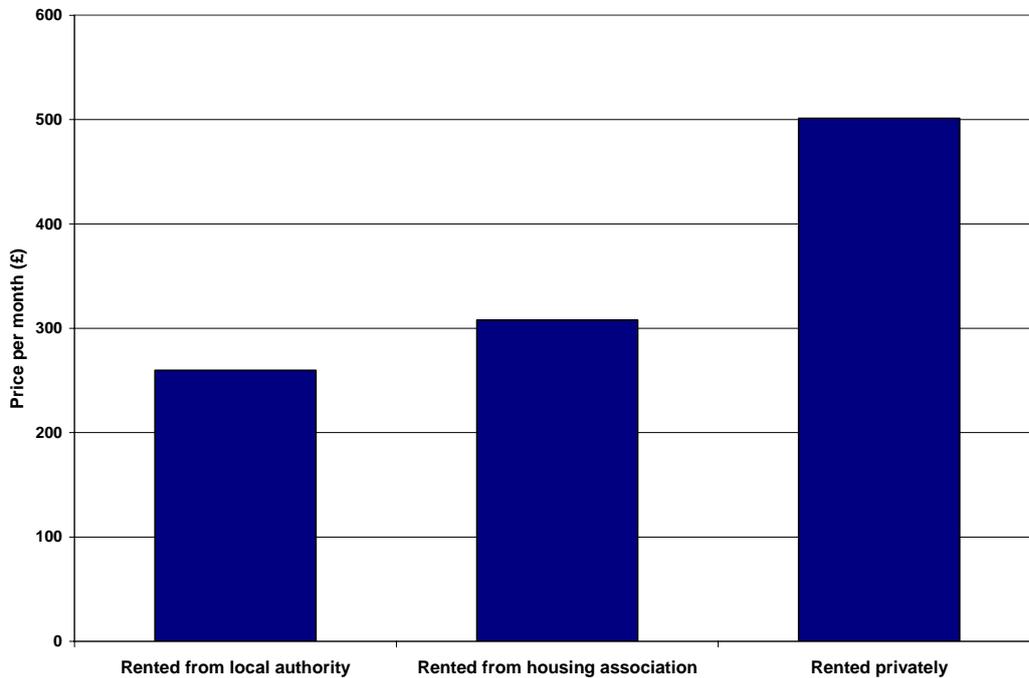
**Figure 9: Housing Benefit recipients by tenure, December 2009<sup>64</sup>**



Housing Benefit is not available to owner occupiers although they are able to access Support for Mortgage Interest (SMI). This benefit provides financial assistance with the interest payments on home loans. However, it is only available after a qualifying period (currently 13 weeks) and there are limits on both the total loan amount and interest rate that can be covered.

Another important difference between tenures is the variation in rental prices (see Figure 10). The median rent in the private rented sector in England was £501 per month in 2007/8. In comparison, the median rent for local authority accommodation was around half of that value at £260 per month and for housing associations it was £308 per month. The full cost of accommodation is not necessarily covered by Housing Benefit, particularly in the private rented sector where the rent paid may be higher than the LHA rate. In March 2010, 48 per cent of LHA recipients received less than the cost of their rent with an average shortfall of £23 per week.<sup>65</sup>

**Figure 10: Rental prices for Housing Benefit recipients, monthly median rent before deduction of Housing Benefit, by tenure, England, 2007/8<sup>66</sup>**



## Lack of clarity of purpose

Housing Benefit is one of the central pillars of housing policy as well as a major element in the social security system. It has underpinned other policies that have transformed the housing system, including the homelessness legislation, the liberalisation of the private rented sector, private finance for housing associations and the transfer of local authority housing to housing associations.<sup>67</sup>

The most basic description of Housing Benefit is that it “is paid to people on a low income to help them meet the costs of their rent”.<sup>68</sup> However, Housing Benefit currently fulfils several roles and purposes, with various governments having added to it over the last 30 years. In some cases these roles have developed as a result of a deliberate policy intention, but in other instances as an unintended consequence. Its current roles are described below:

- Provision of **access to decent housing** for those on low incomes. This key role of is particularly important in London and the South East of England where on average property and rental prices are much higher than in other parts of the UK.

- With Housing Benefit partly or totally meeting rental payments, it ensures that low-income households have a **higher disposable income** to spend on other things. Housing Benefit is a key component of income for those living on low incomes. As a means of providing income for low-income households, Housing Benefit is able to support **wider social objectives** such as social inclusion and reduction in poverty in general and child poverty in particular.
- Housing Benefit provides a **safety net** for low-income households experiencing increases in housing expenditure or decreases in income, with payments being adjusted to meet new circumstances.
- By enabling those on low incomes to rent properties in wealthier areas, it creates **communities that have a broader mix of incomes** than they otherwise would have.
- As an in-work benefit, Housing Benefit has the potential to act as a **work incentive**, but this potential has not been realised.
- Housing Benefit provides support to social landlords' balance sheets by providing a predictable income stream from government, effectively **providing guarantees to lenders**. This enables them to borrow on more favourable rates than would otherwise be the case.
- When paid as Local Housing Allowance to private sector tenants, payment is made directly to the tenants to encourage both **personal responsibility and financial inclusion**. Households then have to budget for and pay their rent themselves, developing budgeting and financial management skills, as well as contributing to financial inclusion as households are required to open a bank account. This is currently only the case for private sector tenants, not for housing association or local authority tenants.
- By increasing the number of people able to afford rents in the private sector, the availability of Housing Benefit is seen as **supporting the private rental market**. However, many private sector landlords are unwilling to let their property to Housing Benefit recipients.
- As an instrument of policy, Housing Benefit can also be used for **wider political purposes**. For example, by choosing to use public funds to subsidise tenants through Housing Benefit, rather than subsidise the construction of new council housing, the Conservative administrations of the 1980s and 1990s were able to contribute towards their goals of a rebalancing from the public sector to the private sector.

With the payment of such large sums of government money to a comparatively large percentage of the population, Housing Benefit has long been susceptible to ‘mission creep’, where the original objective is expanded over time. Evidence of recent thinking about expanding its role can be found in the Consultation Paper issued by DWP in December 2009.<sup>69</sup> These possible new roles included:

- Helping tenants to live in better quality accommodation by vetting of properties in the private rental market before allowing Housing Benefit to be paid to the landlords.
- Improving the carbon footprint of private rented properties, requiring properties to have reached a set level of energy efficiency before they could be let to tenants in receipt of Housing Benefit.
- Acting as a key tool for incentivising work, by making receipt of the benefit more conditional on seeking work.
- Increasing the supply of good quality social and affordable housing in mixed communities.

Further increasing the number of roles that Housing Benefit is expected to fulfil, will only create more complexity, leading to administrative delays and potential increased administrative costs. This will in turn restrict access to housing, as landlords will be less willing to take on Housing Benefit claimants because of potential delays in receiving rent.

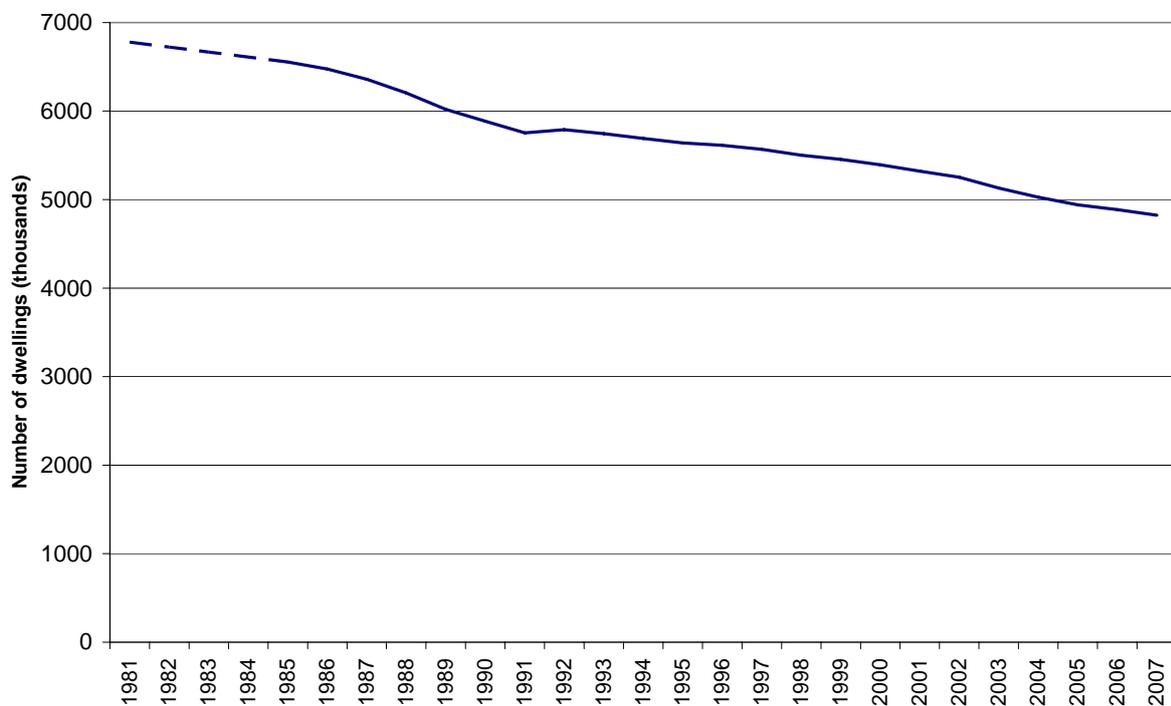
## **Provision of social housing at below market rents**

The second major source of government support with housing costs is the provision of social housing at below market rents. It has already been noted that the median rent for local authority accommodation is around half of the cost of the median rent in the private rented sector.<sup>70</sup> This difference between the rent charged by social landlords and a market rent is described as an economic subsidy. It provides an advantage to tenants of “paying rents that are below those that would give an economic return on the value of the housing stock they occupy”.<sup>71</sup> The Hills review of social housing suggested that this economic subsidy was worth £6.6 billion in England in 2004 and that the majority of the subsidy (approximately 60 per cent) was received by tenants in London, the South East and South West.

This economic subsidy<sup>72</sup> is received by almost all of the 4.6 million households who live in social housing.<sup>73</sup> The number of households in the social rented sector (and therefore the number receiving this economic subsidy) has also

remained relatively stable since 2003 at around 4.6 million, although the longer term trend is one of decline.<sup>74</sup> Almost 1.8 million households, or 4.5 million people, were on local authority housing waiting lists in England in 2009 and were therefore unable to access this economic subsidy.<sup>75</sup> Changes in the absolute size of the social rented sector are largely the result of two factors: Right to Buy sales (which decrease the size of the sector) and completions of new social housing stock (which increase the sector). For almost all of the last thirty years, the rate of Right to Buy sales has been greater than the rate of new build completions. This has led to a reduction in the absolute size of the social rented sector (Figure 11).

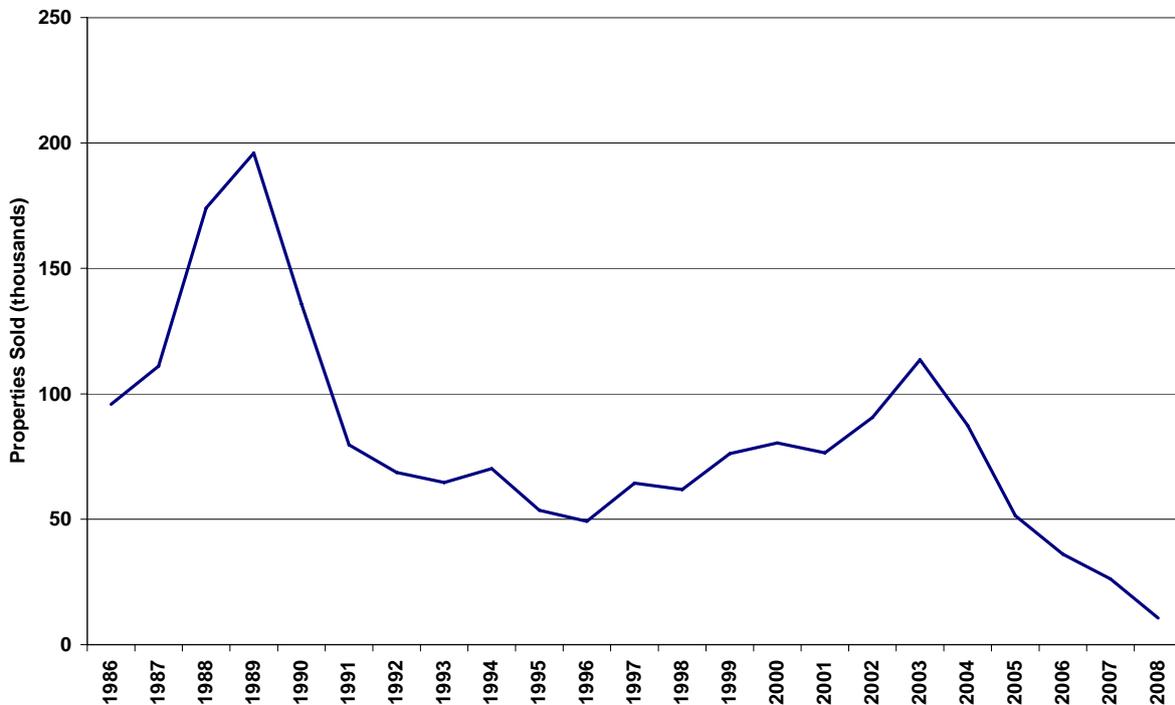
**Figure 11: Size of the social rented sector in the UK between 1981 and 2007<sup>76</sup>**



The Right to Buy scheme offered social housing tenants the opportunity to buy the property that they rented at a discounted rate. This represented a major source of support with housing costs to eligible households. Over two and a half million homes were sold to sitting tenants in the UK through the Right to Buy between 1980 and 2008.<sup>77</sup> These sales peaked during the 1980s at around 196,000 (Great Britain) and then declined during the 1990s (see Figure 12).<sup>78</sup> During the early years of the last decade sales in the UK increased slightly, peaking at almost 115,000 in 2003 but since then there has been a rapid decline to fewer than 11,000 sales in 2008. The future of the Right to Buy is likely to vary between the component countries of the UK. The Welsh Assembly has received powers to suspend the Right to Buy in areas of chronic housing

shortages and the Scottish Government intends to legislate to remove the Right to Buy for newly built homes.<sup>79,80</sup>

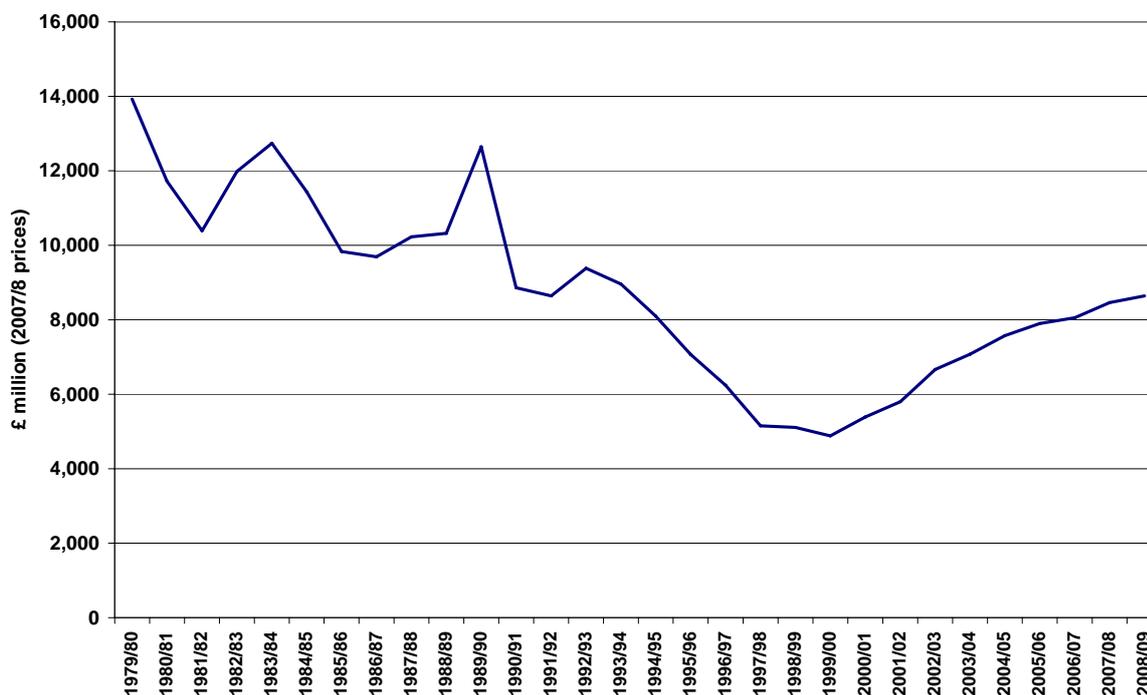
**Figure 12: Properties sold through Right to Buy between 1986 and 2008 (Great Britain)<sup>81</sup>**



Many social housing providers receive capital subsidies to support new development of new accommodation that can be rented at below market rents. Capital subsidy to support social house building in 2008/09 was estimated to be £7.3 billion for England and £8.6 billion for Great Britain. The historic trend for investment in social housing can be found in Figure 13 below.

Capital subsidy is coordinated by the devolved administrations. In December 2008 a new housing and regeneration agency was created in England called the Homes and Communities Agency (HCA). This brought together government capital investment in affordable housing into one organisation with an annual budget of around £5 billion. In March 2006 Communities Scotland (which was broadly equivalent to the HCA in England) was abolished to facilitate the amalgamation of policy and delivery of investment in housing and communities into the core Scottish Government. In Wales the Social Housing Grant is allocated by the Welsh Assembly Government, with much of the prioritisation of projects being devolved to local authorities.<sup>82</sup> The Northern Ireland Housing Executive is a non-departmental public body, and the overall housing authority in the province.<sup>83</sup>

**Figure 13: Gross government social housing investment in Great Britain, 1979/80 to 2008/09 (constant prices) <sup>84</sup>**

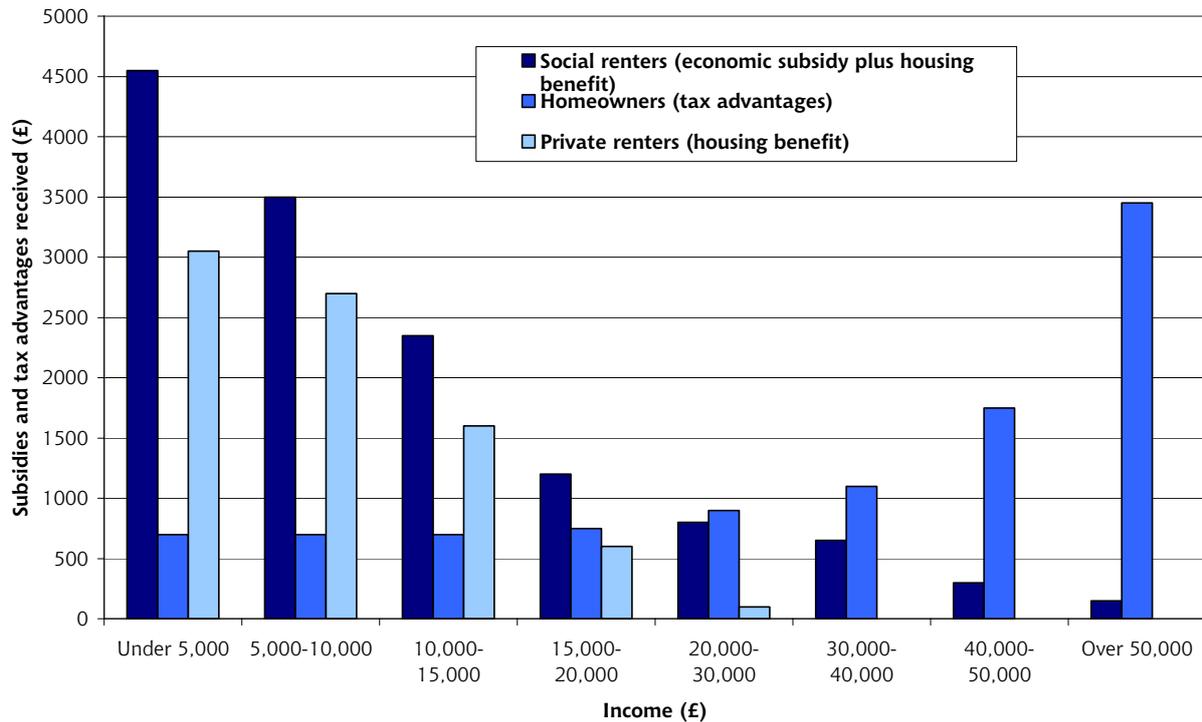


Social housing providers argue that this capital investment from government keeps rents lower in this sector and levers in private finance worth several times the value of the government investment to provide more homes than would otherwise be delivered.<sup>85</sup>

## Favourable taxation of owner occupiers

The third major source of government support with housing costs is the favourable taxation of owner occupation. This source of support with housing costs is probably the least well known and is rarely analysed in policy discussions. Owner occupiers receive tax advantages that are not available in the other market tenure, the private rented sector. This has been described as a “continuing significant fiscal bias in favour of home-ownership relative to renting”.<sup>86</sup> The relative tax positions of the tenures are complex, but there are significant differences between them. For example, landlords pay Capital Gains Tax on the sale of private rented sector accommodation, but owner occupiers do not on their primary residence. A report published by Shelter has summarised both the tax and subsidy position of households in the three major tenures for different income levels (see Figure 14).

**Figure 14: Housing-related subsidies and tax advantages by income band and tenure<sup>87</sup>**



The amount of income that is foregone by the favourable taxation treatment of owner occupation is comparable in scale to the total Housing Benefit bill. The tax reliefs to owner occupiers have been estimated at between £23.7 billion and £28.4 billion per year for the years from 2002/03 to 2007/08, although with the recent economic downturn the estimate has fallen to £15.9 billion for 2008/09.<sup>88</sup> The specific tax advantages included within those estimates are the absence of a tax on imputed rents (which was known as “Schedule A tax” when it was levied in the UK) and the fact that principal residences are exempt from Capital Gains Tax (CGT).

Figure 15 summarises some of the key taxation treatment that applies to the private housing tenures. It includes taxation that applies across the sector in question, irrespective of the party that is charged it: for the private rented sector it includes both taxes that are paid by landlords and those paid by tenants, for best comparison with owner occupation, where effectively the owner occupier fills both roles. It should be noted that the ultimate incidence of taxation does not necessarily fall on those who are charged it: tenants may end up effectively paying for a tax levied on landlords if it is passed on in higher rents, or landlords may end up bearing the cost of a tax paid by tenants if it acts to force rents down. Consequently it makes sense to consider the taxation of the private rented sector as a whole.

**Figure 15: Summary of taxation treatment of private tenures**

<b>Tax</b>	<b>Owner occupation</b>	<b>Private rented sector</b>
Capital Gains Tax	No. (Primary residences exempted.)	Yes.
Taxation on rent	No. (This was the Schedule A tax on imputed rent, which was removed in 1963.)	Yes.
Offset expenditure against income tax	No. (But as owner occupiers are not being charged income tax on imputed rent there is nothing to offset against.)	Yes – mortgage interest as well as repairs and maintenance.
Stamp duty land tax (SDLT)	Yes.	Yes. (The rules relating to linked purchases mean that one landlord buying several properties may have to pay SDLT at a higher rate than several owner occupiers each buying one property.) <sup>89</sup>
Council tax (not a housing tax, but loosely related to property prices)	Yes.	Yes.
VAT on new construction	No.	No.
VAT on repairs	Yes. (Reduced rate for some conversions, renovations and installations.)	Yes. (Reduced rate for some conversions, renovations and installations.)

Key

Tenure is favoured	Neutral	Tenure is disadvantaged
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## Other forms of support

As well as the three main forms of support described in detail above, there are several other forms that support with housing costs can take. Some of these exist in the UK, but contribute to a much smaller degree than the primary forms; some have been used here in the past; others are used in other countries. Below are brief descriptions of some of these alternative forms of support.

### Support for Mortgage Interest (SMI)

Previously known as Income Support for Mortgage Interest (ISMI), SMI is a benefit paid to owner occupiers on the interest component of their mortgage payments. The conditions for payment of SMI are generally more constrained than renters face to receive Housing Benefit. For example, SMI is only paid on loans up to a single limit and is paid at the Bank of England's average mortgage rate. Between 2000/01 and 2007/08 the ISMI / SMI bill was between £303 million and £488 million per annum.<sup>90</sup>

### Private sector rent controls

Prior to the Housing Act 1988, there were controls on the levels of rents that could be set in the private rented sector. These controls still exist for tenancies that pre-date the changes brought about in that legislation.

Rent controls can take different forms and have an important role in the housing systems of other countries. For example in Norway tenants can file a complaint to a government agency if they think that their rent is too high. Rent controls are often considered necessary in systems where private tenants have security of tenure, as otherwise landlords could regain control of a property by simply inflating rents.

### Low cost home ownership

Low cost home ownership grants are intended to provide support to help people become owner occupiers who would otherwise not be able to afford to do so. A variety of low cost home ownership grants have been available since the 1970s. Current schemes include shared ownership (where people buy part of the property and rent the rest) and HomeBuy (where people can access a low cost loan for part of the purchase price).<sup>91</sup> In 2007/08, approximately £523 million was spent on low cost home ownership grants.<sup>92</sup>

# A coherent vision for support with housing costs

Participants at the *Future of Housing* Consultation in June 2009 accepted, as a broad direction of travel, the view of Europe's not-for-profit housing providers that "a housing system should provide access to **decent and affordable housing for all**, in communities which are socially, economically and environmentally sustainable and where all are enabled to reach their full potential".<sup>93</sup> There is also widespread consensus across the political parties that everyone in the UK should have access to decent and affordable housing.

Given the basic objective of the UK housing system, to provide decent and affordable housing, there is a fundamental need for support with housing costs. This forms a strong foundation to assess what we want to achieve in providing support with housing costs and how that might be delivered.

- The goal of achieving **decent and affordable housing for all** must be used as the direction of travel for both **short and long term changes** to support with housing costs.
- In order to safeguard the provision of decent and affordable housing for future generations it is important that support with housing costs is **politically and financially sustainable in the long term**.
- Support with housing costs needs to form part of wider housing and economic policies that are **coherent and complementary**.
- Support with housing costs should do no harm to the wider housing system, including its impact on:
  - Minimum quality and safety standards;
  - Economically and socially sustainable neighbourhoods;
  - Improving energy efficiency.

# Options for reform

The vision described in the previous section provides a strong foundation for the future of support with housing costs. It helps to clarify the objectives for the system and begins to narrow the options for achieving them. This section moves on to look at detailed options for reforming the main forms of support with housing costs described in the early sections of this report.

At their simplest, the approaches to providing support with housing costs can be considered to be in two broad categories: those that seek to reduce the cost of housing services and those that distribute money to households to put towards housing costs. The former includes most supply-side subsidies, as well as measures aimed at increasing the supply of market housing to decrease (or limit rises in) the price. The latter includes Housing Benefit, currently the predominant form of expenditure on support with housing costs, and Support for Mortgage Interest. In an economic sense it also includes the favourable taxation treatment of owner occupation, although this is 'paid' by foregoing an income, rather than as an explicit transfer of funds.

## Sustainability

As the sustainability of the system of support with housing costs is vital if we are to continue supporting households in the future, serious consideration must be given to the balance between these types of support. Whilst there will continue to be those for whom a subsidy is needed to be able to cover their housing costs, broadly speaking it is more sustainable to decrease the cost of purchasing housing services, reducing both the number of people who need, for example, Housing Benefit, and the level of Housing Benefit needed by those who do continue to receive it.

Although this analysis indicates a general movement away from revenue subsidies like Housing Benefit, due to the substantial variations in housing costs across the country it seems inevitable that any sustainable system will retain some component roughly equivalent to the current Housing Benefit, to be able to reflect those differences in the costs. As noted above, this is not a new problem, and was identified as far back as the Beveridge Report of 1942<sup>94</sup> as the issue of "Benefit Rates and the Problem of Rent"

In addition to economic sustainability, it is important to consider the political sustainability of Housing Benefit. Public expenditure needs both political and popular support if it is to be maintained over the long term. Some areas of

public spending, such as healthcare, have greater levels of political and popular support. This has led to healthcare budgets being protected from spending cuts in the 2010 spending review. Housing Benefit has a low level of popular and political support. There has been extensive condemnation in some sections of the popular press of cases where Housing Benefit claimants have been reported to be living in expensive central London properties that cost up to £1,600 per week.<sup>95</sup> In August 2010, the Prime Minister, David Cameron, described fraud an error in the benefit system as “absolutely outrageous”.<sup>96</sup> Reforming Housing Benefit to clarify its purpose and improve its delivery could increase its political stability. Clearly demonstrating what Housing Benefit achieves would make it stronger. Capital support may also be more politically sustainable than revenue support, if it is possible to demonstrate to the public that the investment is securing an asset that will be able to meet housing need in the long term.

## Reforming Housing Benefit

### Changes announced by the coalition government

A number of changes to Housing Benefit were announced in the emergency budget of June 2010 and are summarised earlier in this report. The net intention of these changes was to reduce spending on Housing Benefit. BSHF has previously published a detailed analysis of the likely impact of those measures.<sup>97</sup> In addition to these changes, in October 2010, the chancellor announced a cap on the total amount of benefits that can be paid to a household. This cap will be set at the median income level and administered through the Housing Benefit system.<sup>98</sup> The government has also announced its intention to move towards a single Universal Credit that would include Housing Benefit. The reforms were outlined in a consultation titled *21<sup>st</sup> Century Welfare*, to which BSHF has submitted a response.<sup>99</sup>

Whilst the government’s aspirations to undertake the important task of reforming the UK’s unduly complex system for support with housing costs are commendable, several of the mechanisms adopted in the budget give cause for concern. There is a risk they will:

- Have unintended consequences that act to negate the public expenditure savings that are expected;
- Fail to meet one of the stated aims of the budget which was to support the most vulnerable;
- Undermine the core purposes of Housing Benefit;
- In the longer term, concerns will centre on the potential for the creation of Parisian-style *banlieues*, areas on the outskirts of the city with

concentrations of deprivation, while the city centre becomes exclusively for the very well off.

The possibility that the changes may have unintended consequences that act to minimise the public expenditure savings deserves particular attention. If the changes merely shift public expenditure from one budget (Housing Benefit) to others then they will be difficult to justify. For example, if changes lead to households being made homeless, local authorities will see increased homelessness workloads, and hence expenditure. As well as the social costs of this, there are clear economic costs: a report for Business Action on Homelessness found that the annual cost to the state of a homeless person is £26,000.<sup>100</sup> This estimate is likely to be on the low end of the scale, as the study used conservative estimates, including studying a subset of the homeless population that was likely to be ready for work. More generally, various studies have identified substantial costs to society and the state resulting from poor housing. Most recently Roys et al's analysis<sup>101</sup> estimated that the cost to society of issues related to housing failing to meet the statutory minimum standard for housing in England may be greater than £1.5 billion per year, while Friedman<sup>102</sup> examined several costs related to the impact of poor housing, and concluded:

- Costs assessed for a basic police response to crimes related to poor housing conditions, plus the costs of burglary and criminal damage in these cases amount to **£1.8 billion per annum**;
- The cost of treating medical conditions associated with poor housing conditions (excluding loss of earnings and any other related forms of treatment or therapy) is **nearly £2.5 billion per annum**;
- There is strong evidence that poor housing conditions result in educational underachievement. Purely based on differences in GCSE results, lost earnings of **£14.8 billion pounds** were forecast for the current generation in poor housing.

As currently structured, Housing Benefit is inherently responsive to the economic cycle: as expected, the cost has risen in a downturn. This does not represent a flaw in the system; it represents an element of the country's welfare provision responding to an increasing number of people needing support in tough economic times.

In general, Housing Benefit expenditure should not be cut significantly in the short term, as resulting problems (including increased homelessness and other poor housing outcomes) will be created elsewhere, the economic consequences of which are likely to outweigh any savings achieved. The majority of the recent

increase in Housing Benefit expenditure is due to increasing number of claimants which in turn is likely to be due to increased unemployment. A **reduction in claimant numbers through lower levels of unemployment** provides the most effective option for addressing Housing Benefit expenditure in the short term. Over the medium to long term, the government will need to address increases in rental prices, otherwise savings made through people returning to work and coming off Housing Benefit will be offset by the rates paid increasing for those who continue to claim.

## Simplification of purpose

As noted above, Housing Benefit currently fulfils a wide range of functions. This diversity of roles prevents a clear focus on ensuring its core functions are met, or even a shared understanding of what those core purposes are. Defining a clear purpose for Housing Benefit, and focusing any reforms on meeting those aims will increase its chances of success.

A clearer and tighter focus for Housing Benefit does not mean, however, that other objectives should be allowed to fall by the wayside; those objectives that are deemed not to be the core purposes of Housing Benefit will need to be addressed in alternative ways. For example, in the past it has been suggested that Housing Benefit might be asked to play a role in improving the standard of accommodation in the private rented sector. Whilst, undoubtedly, the intention of increasing the quality of private rental properties is good, Housing Benefit should not be used to achieve it. Alternative measures might include a degree of regulation, or increased enforcement of existing standards. Introducing a link between Housing Benefit and property standards would risk increased delays in processing payments and a reduction in the number of private sector landlords willing to let their properties to Housing Benefit recipients.

Conversely, whilst the Housing Benefit system should not be asked to directly achieve too many things, care should also be taken in its construction to ensure that it does no harm to other areas of policy. For example, whilst its primary focus should not be incentivising movement into work, Housing Benefit should not pose barriers to work. The likely long term social impacts of a Housing Benefit system that fails in its objectives could include greater marginalisation of the poor, with potential for increased crime and anti-social behaviour.

In Europe, the Council of Europe's guidelines<sup>103</sup> on the effective use of housing allowances<sup>104</sup> state:

*“The goals for a housing allowance system should be to improve access to decent, affordable housing for all households on low incomes and to function as a safety net for these households against increases in housing expenditure or decreases in income.”*

Further analysis is necessary to assess whether that guideline covers accurately, and in full, the objectives that would suit a Housing Benefit system in the UK’s context. However, as a broad principle, there are many merits in adopting a narrow purpose for Housing Benefit, and not attempting to use it to achieve policy objectives that are non-core for the benefit. Housing Benefit is more likely to be successful if it is only trying to fulfil a limited number of roles and is doing them well, than if it is used to achieve multiple and potentially conflicting policy objectives.

It is worth noting that the Council of Europe definition includes “all households on low incomes”. In the UK context, because of the significant differences between owner occupation and renting, it may make sense to exclude owner occupiers on low incomes from our Housing Benefit, at least at present. In doing so, it is acknowledged that there is a group that is being explicitly excluded, and noted that alternative provisions must exist for this group.

## Simplification of operation

Clearer **objectives** for Housing Benefit could underpin a simplified **model** of Housing Benefit delivery. A number of the difficulties with the current Housing Benefit system could be addressed by a simplified system. These could include simplifying the administration of claims (making it easier to reduce processing times or administrative costs), improving understanding of the system by the public (including claimants and prospective claimants) and reducing work disincentives. A simplified system could be designed to be revenue neutral (i.e., the rates could be set at levels such that the overall cost of the new system is equal to the current system).

As a matter of principle, subsidy should be transparent to consumers, to taxpayers and to government. It should be clear what is being paid for.

There remains a clear need for a separate benefit linked to housing (or at least a component of a broader benefit that varies depending upon housing) due to the huge variation in rent levels across the country. A benefits system that failed to reflect differing housing costs in different parts of the country would fail in many areas.

In some instances further cuts could be made to the length of time processing the case through improved administration, bringing the slowest authorities up to the standard of the quickest. However, a significant contributory factor to the length of time a claim can take is the complexity of the current system. Improving processing times might increase the number of landlords willing to accommodate Housing Benefit claimants

Housing Benefit is very complex and difficult for professionals, let alone the general public to understand. This complexity makes Housing Benefit almost incomprehensible for claimants. There is no easy way to tell what will happen to your benefits if your circumstances change in a certain way. It is likely that this complexity is a key factor in the perceived failure of Housing Benefit as an in-work benefit. The fear of losing Housing Benefit (in the absence of clear information one way or the other) may create as much of a work disincentive as the actual fact of how it will be withdrawn.

The complexity of the Housing Benefit system makes it difficult to justify to the general public. Housing Benefit provides a major part of the income of many of the most vulnerable people in our society. However, it is harder to demonstrate this impact than it is for simpler benefits such as the old age pension and child benefit. Cases of fraud and error in Housing Benefit claims are difficult to detect with a complex system, which further undermines public confidence in the system.

A simplified model of Housing Benefit delivery could address some of these difficulties with the current system. Other European countries, such as The Netherlands,<sup>105</sup> operate much simpler systems of housing allowances. These examples show that simplification of the UK Housing Benefit system is possible.

### **Principles for reform**

The complexity of the current system means that a full consultation with stakeholders from across the housing sector would be necessary to ensure that a simplified system did not create unintended negative consequences. Whilst the detail of a simplified model would need careful consideration, there are a number of principles that are fairly well developed.

- The first principle is that the Housing Benefit system needs to **respond to how people now live**, reflecting the major structural and demographic changes that have taken place since the design of the welfare state after the Second World War. These include changes towards household structures which are more fluid and complex. There have also been major changes in the labour market with increases in shorter contracts and individuals

changing jobs more regularly. The current Housing Benefit system is not able to keep up with the changes in household circumstances.

- A Housing Benefit system that is designed to be **“roughly right rather than exactly wrong”**<sup>106</sup> could provide the second principle for a simplified system. At present, the complexity of the Housing Benefit system is due to it being designed to closely match changes in household income and structure. A simpler method of calculating Housing Benefit could be achieved by using broader categories of rent paid, income and household type. The Dutch housing allowance system, for example, has a small number of household types. Likewise, income and rent could be broken up into broad bands. This would create a fixed number of Housing Benefit payment rates that could easily be understood and accessed by claimants, advisors and the general public in ‘look up tables’ or simple online calculators. A more basic system such as this would need to be carefully tested to analyse its impact on different groups of people but could provide a direction of travel to overcome the counterproductive levels of complexity in the current system.
- Greater use of **fixed period awards** could be the third principle for a simpler Housing Benefit system. This could complement the ‘look up table’ approach and create greater stability for low income households, particularly those in marginal employment. Fixed period awards were discussed in the recent Department for Work and Pensions consultation<sup>107</sup> on Housing Benefit as a way of supporting people into work and responding to people whose income varies significantly over time. Fixed period awards, maybe lasting six months, would be of real benefit for people who are constantly shifting in and out of work or between part and full time. It could be adopted with the option for a break clause where there is a major change in your circumstances that has to be taken into account.
- A fourth principle for a simpler Housing Benefit system might be derived from detailed consideration of whether it would be better to have a **different system of Housing Benefit for pensioners**. The current system may work better for pensioners than those of working age as pensioners tend to have more stable incomes and household structures. Whilst there would be a cost in having two systems instead of one it may be a more efficient way to respond to groups with different life circumstances. For example in countries such as Finland, Denmark and Sweden there are separate systems for pensioners.

- The fifth principle for simplification would be that Housing Benefit entitlement **should not vary depending on when the original claim was made**. Over time adjustments could be made to remove all the old systems for calculating tenants' Housing Benefit entitlement. At present a number of different historic Housing Benefit systems are still running. The earliest of these protected statuses dates back to before January 1989, but other significant changes include those made in January and October 1996 and the 2008 move to the Local Housing Allowance system. Although this move would reduce the benefits received by some, as the earlier schemes are typically significantly more generous than the current one, at a time when the government is willing to make cuts to the benefits of the poorest in society it seems that the least negative option for those cuts would be to target the relatively generous systems. In doing so, genuine transitional measures would need to be adopted, for example phasing from claimants' current entitlement levels to those calculated under the new system over a period of, say, four years. Such phasing would retain some of the complexity of the current multiplicity of systems in the interim, but that would be a small price to pay for providing some measure of protection for those affected whilst still moving over to a single and simplified system within a defined timescale.
- The next principle for simplification would be to **remove the differential treatment of younger people**. The current Housing Benefit system limits payments to younger households to lower levels than those available to other households. Specifically, the rules for single people aged under 25 limits their entitlement to a single room rent (SRR). Analysis of this has highlighted particular problems, including that 87 per cent of all SRR claimants face a shortfall between what they receive in Housing Benefit and what they pay in rent, averaging £35.14 per week, and that there is a shortage of accommodation available to under 25s which meets the SRR definition. These issues have been shown to cause further problems, where charities working with young homeless people are unable to move people on to appropriate accommodation because of the impact of the SRR and the greater risk of social and financial exclusion created by the SRR.<sup>108</sup>
- A final principle for simplification should be that it does not harm the wider housing system. For example it would be important to ensure that simplification does not lead to an increase in homelessness. Due to the potential costs (economic, as well as social) of homelessness, proposed alterations to the Housing Benefit system should be "homelessness proofed". They should be tested and carefully analysed to see whether they are likely to create additional homelessness. Whilst superficially there is no reason why the move to a simplified system should lead to an increase in

people experiencing homelessness, the devil is in the detail. For comparison, see BSHF's analysis of the Housing Benefit measures contained in the emergency budget of June 2010,<sup>109</sup> which illustrated several ways in which the measures could lead to increased homelessness in the short, medium and long term. The Housing Benefit system also provides a predictable income stream to housing associations allowing them to develop more social housing. Changes to Housing Benefit could limit the provision of new social housing and mean that more recipients move to the private rented sector which is more expensive.

In summary:

- There is still a clear need for a housing allowance that reflects local variation in rents;
- Reform of Housing Benefit is needed to provide a clearer purpose and a narrower focus on maintaining residual incomes;
- This narrower focus for Housing Benefit will only work if it sits within coherent housing and economic policies that address the root causes of increase in Housing Benefit costs. These wider issues are addressed in more detail below.

## **Increasing the supply of housing**

There is a clear case for reform of Housing Benefit. However, as noted above, demand side subsidies such as Housing Benefit are not enough on their own, and a sustainable approach must include policies that ensure that the cost of housing becomes affordable for more people without needing recourse to a revenue benefit. These can include the subsidy of social rented housing, but also wider policies that seek to increase the supply of market housing, and hence act to suppress price rises through a changed balance of supply and demand.

Since the early 1990's successive governments have relied on Housing Benefit to "take the strain"<sup>110</sup> of housing policy. It may now be time for supply side 'bricks and mortar' subsidies to take more of the strain to ensure that housing support is financially sustainable in the long term. Whilst the economy is strong it is easy to rely on revenue subsidies which can be covered by healthy tax receipts. Problems arise if tax receipts fall and claimant numbers increase at the same time, which is the situation that has arisen since 2008. Securing the long term financial sustainability of support with housing costs will also require a greater focus on the provision of affordable housing with a specific emphasis on

increasing the provision of social housing at below market rents in areas of high demand.

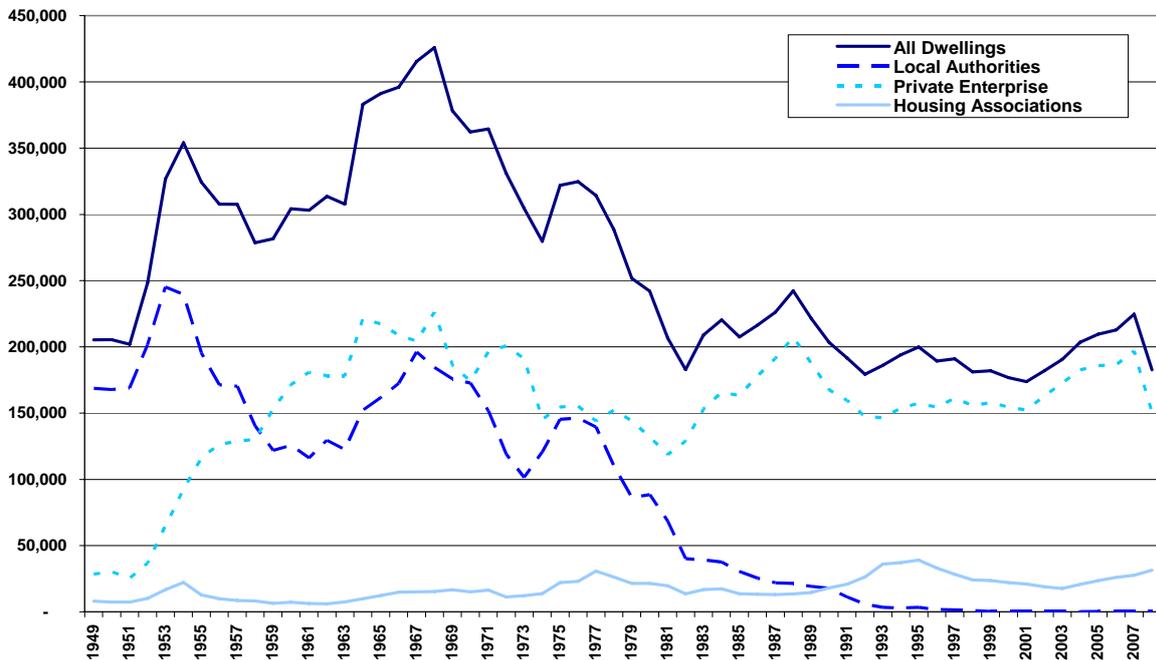
The evidence noted above suggests that expenditure on Housing Benefit has increased primarily for two reasons. Since the start of the recent recession, the increase in expenditure is largely due to rising numbers of working age claimants. Prior to the recession the increase in expenditure on Housing Benefit was due to rising rents. It is this longer term trend that demonstrates that the sustainability of the support can be best ensured by adopting policies that seek to restrain housing costs (including rents). This is unlikely to be resolved without serious attention to the supply side of the housing system, ensuring more homes are developed to suppress increases in housing costs.

Under-supply of housing generally in the UK is widely considered to have significant negative social and economic impacts, perhaps most notable of which are high and volatile house prices.<sup>111</sup>

## Supply of social housing

There has been a particular problem with producing sufficient social rented housing over the last 30 years (Figure 16), since local authority housing development dropped to close to zero and housing association development failed to replace that lost stream of development. Under-supply has resulted in 1.8 million households on social housing waiting lists,<sup>112</sup> constraining access to the sector and consequently contributing to its residualisation, where social housing is only available to the poorest in society. This has resulted in what Iain Duncan Smith has referred to as a “housing system [that] has ghettoised poverty, creating broken estates where worklessness, dependency, family breakdown and addiction are endemic”.<sup>113</sup>

**Figure 16: House building in the UK, permanent dwellings completed, by tenure, 1949 to 2007<sup>114</sup>**



It should be noted that the supply of increased quantities of social rented housing can act to suppress the price of housing for those accessing their housing in the market, as well as those who obtain a social rented tenancy. By providing some people with accommodation in the social rented sector, the number of people competing for, for example, private rented sector tenancies is reduced, which may exert a downward pressure on private rents.

## Options for increasing supply

Last year BSHF published *The Future of Housing* which highlighted almost 40 possible options that might contribute to an increase in housing supply.<sup>115</sup> Some of the most well developed and widely supported proposals are listed below.

- Amending the Right to Buy scheme to ensure that most or all of the receipts from sales are recycled into providing new social rented housing stock.
- Rebalancing capital and revenue subsidies, to provide greater investment in the development of a long term social housing asset for the nation.

- Revisiting 'best consideration' rules to ensure they are not preventing public bodies from making innovative use of their land assets as subsidy during a period when other sources of subsidy are constrained.
- Increasing the provision of desirable accommodation purpose built for older households, to free up family homes and make better use of the existing stock. Where appropriate, these properties should be located in or near to existing communities to give those downsizing the option of doing so without moving out of the area. Work to increase this provision should feature delivery of homes in a range of tenures, including investment in provision of social rented homes of this type.
- Switching the UK to the GGFD system of accounting in a phased manner, to better reflect the status of local authorities' landlord functions and safeguard the status of housing association debt as off balance sheet.
- Considering the merits of existing innovative structures that housing associations and local authorities have established to deliver housing for communities, and if appropriate support their wider adoption.
- Supporting the establishment of a housing innovation agency, to conduct experiments into housing provision.
- Providing support for housing delivery mechanisms that harness the efforts of members of communities, such as self-help housing, as part of the Big Society programme.

Further ideas that merit consideration include: efforts to make use of the equity in the balance sheets of non-developing housing associations; the possibility of social landlords being enabled to take a more flexible approach to asset management (for example selling off some stock at market rates as it becomes vacant and reinvesting in new homes); and the possibility of social landlords participating in the market rental sector to increase the delivery of well-managed housing stock, potentially cross-subsidising their social rented stock. The limited supply of housing is a major structural issue that requires urgent and sustained attention from both government and other stakeholders from across the UK housing system.

Other areas that contribute to the level of supply that occurs in the UK should also be considered. Chief amongst these is reform of the planning system. The coalition government has proposed and made a number of changes to the system, and it remains to be seen whether these will contribute to increased or decreased delivery of new housing.

## Supply-side implications of the emergency budget

The Housing Benefit system largely falls under the remit of the Department for Work and Pensions (DWP). Responsibility for the bulk of housing policy, however, sits with the Department for Communities and Local Government (CLG) in England and is devolved in both Scotland and Wales. The impacts of changes to Housing Benefit on the supply of accommodation (in both the private and social rented sectors) should be of particular concern to ministers responsible for housing, and close working between the departments in the respective governments will be essential.

In the private rented sector, the proportion of landlords who are willing to let to households receiving Housing Benefit may fall further. As tenants' benefits payments seem even more uncertain than they were previously, the ability of private landlords to finance the acquisition and improvement of homes may be hindered. Private landlords may decide to stop renting to Housing Benefit recipients altogether if they can find alternative tenants, making it harder still for benefit recipients to secure accommodation.

The impact on the private rented sector will be further affected, albeit to different amounts across the country, by the decision to link Local Housing Allowance rates to the Consumer Price Index (CPI). In the areas that experience the highest rent increases following the indexation, there is likely to be a substantial increase in the number of people experiencing a shortfall between their actual rent and the amount permitted under the Local Housing Allowance. This in turn is likely to lead to increasing hardship for tenants or rent arrears and tensions between landlords and tenants, probably with the long term effect of further reducing the supply of properties that landlords are willing to rent to Housing Benefit claimants.

Similar effects will also face social landlords, whose business plans and financial strength are reliant to a large extent on tenants receiving Housing Benefit. Two elements of the budget will affect social landlords' anticipated income streams: the under-occupation provisions and the 10 per cent reduction for tenants who have been claiming Jobseeker's Allowance (JSA) for a year. In both cases the assumed income streams will now be lower than previously expected. More often than not, landlords will have borrowed against their income streams substantial amounts of money from bankers who will be keen to get that money back or to see it re-priced. This weakened financial position for social landlords could ultimately lead to their being less able to contribute to the supply of new stock.

## Cross tenure approach to housing support

A coherent approach to support with housing costs will need to deal with the relationships between different tenures. In order to ensure that everyone in the UK has access to decent and affordable housing it will be necessary to look at a combination of policies that will minimise risk to individuals and communities. These will need to include reform to Housing Benefit, rebalancing supply and demand subsidies, and reassessing the relationship between owner occupation and renting. Ideally this would ensure as much neutrality as possible between tenures.

A universal housing allowance which provides support with housing costs regardless of tenure has long been discussed as a possible solution to the differences in tenures.<sup>116</sup> However, in the current economic circumstances, and especially given the current differences between the tenures, it may be more effective to look at other ways of balancing the support provided in different tenures. There is still a need to look carefully at the role of owner occupation in support with housing costs.

## The role of owner occupation in the UK housing system

Owner occupation is different from renting. Tenants occupy housing as a consumption good, whereas for owner occupiers the purchase of housing is also often viewed to provide the opportunity to build up an asset at the same time as meeting housing requirements. The majority of households in the UK are owner occupiers. The proportion of households who are owner occupiers has recently started to decrease for the first time in over one hundred years, from a peak of almost 71 per cent of households in 2005 it had fallen back to around 68 per cent by 2009.<sup>117</sup> This relative decline is due mainly to the growth in the private rented sector which increased by one million households during this period.

Projections suggest that owner occupation may continue to decline in the short and medium term.<sup>118</sup> A particularly important barrier to owner occupation is mortgage availability. There is also a need to recognise that owner occupation is not attainable or desirable for every household. Owner occupation can also be part of the story of disadvantage: around half of the poorest 10 per cent of households in the UK are home owners.<sup>119</sup> The experience is even more striking in several Eastern European countries, where tenants were given properties for free or at substantial discounts after the fall of Communism; it demonstrates that even outright ownership is not a panacea as it can lead to problems of quality and disrepair if households do not have the resources to maintain their property.<sup>120</sup>

Other options must be available for people who cannot or do not want to become owner occupiers. In recent years there have been major government reviews of the roles of social housing<sup>121</sup> and private renting.<sup>122</sup> There is a need for greater clarity on the roles that we wish owner occupation to play in the UK housing system.

## Financial support for owner occupiers

Owner occupiers are not entitled to claim Housing Benefit. At present, Support for Mortgage Interest (SMI) is available to owner occupiers who are claiming Income Support, income-based Jobseeker's Allowance, income-related Employment and Support Allowance, or Pension Credit,<sup>123</sup> with constraints on the amount that can be claimed and the times at which it can be claimed. Given that current government policy is to reduce spending rapidly, there is little chance that Housing Benefit will be extended to owner occupiers in the near future.

It has already been noted that there are significant differences between owner occupation and renting. As well as the favourable taxation treatment of owner occupation, the tenure provides both consumption and investment opportunities. Although support systems can be designed that seek to address these issues (for example by providing support exclusively for the interest component of mortgage payment, not the capital repayment), these differences warrant the continued distinct treatment of owner occupation in the housing support system, certainly until and unless the taxation treatment is harmonised, and potentially in the longer term.

That does not mean, however, that the current very limited support with housing costs that is available to owner occupiers experiencing difficulties (aside from their existing beneficial taxation treatment) should be left unaltered.

An alternative proposal that merits close attention is the Sustainable Home Ownership Partnership (SHOP), designed by a team at the University of York for the Joseph Rowntree Foundation.<sup>124</sup> In brief, participation in SHOP would be compulsory for all new and remortgaging borrowers, with contributions providing insurance against the 'designated' risks of unemployment, the failure of self-employment, accident or sickness. Three parties would contribute to the scheme: the borrower would pay 50 per cent of the cost, and the lender and government would pay 25 per cent each.

One option for less fundamental reform of SMI would be to introduce geographical variation into the rates paid. At present SMI is based on actual

eligible mortgage levels, subject to a single national limit. In a forthcoming paper for the Joseph Rowntree Foundation, Professor Steve Wilcox will argue that “[given] the extent to which mortgage costs vary across the country it is difficult to see the rationale for a single national limit. While that limit might bear in on households in London (with limited options to trade down unless they move out of London); it would be relatively generous in other parts of the country.”<sup>125</sup>

## Tenure neutral taxation of housing

It has already been noted that the favourable taxation of owner occupation represents a major subsidy to households in this tenure. The foregone income from this benefit to owner occupiers represents a substantial cost to the government (£15.9 billion to £28.4 billion per year).<sup>126</sup> This cannot be justified in a period where the government is seeking to cut the budget deficit quickly. Steps should be taken to neutralise the advantageous tax treatment of owner occupation in relation to private renting. This could take the form of the reintroduction of Schedule A taxation on imputed rents combined with a restructuring of property and land taxes, with the effect of taxing capital value on an annual, rather than transactional, basis.

The recommendation above to investigate property or land taxes, rather than simply applying Capital Gains Tax (CGT) to principal residences reflects the unintended consequences that such a move would have. Briefly, applying CGT without any roll over relief would significantly hinder mobility, as many households would face large tax bills move to a similar or more expensive property. However introducing CGT with roll over relief would mean it would typically only be paid by households that were downsizing, which would create a disincentive to moves in that direction; this would be undesirable as there is generally a need to free up larger homes.

Detailed proposals for a property or land value taxation charged to owners would need to consider the impact on the social rented sector. As a not-for-profit sector it would, of course, be possible to consider a different taxation treatment for social landlords from the one harmonised for owners in the market sectors.

An alternative housing taxation system could also help to address the long term issue of house price volatility, addressed elsewhere in this paper. The Housing Market Taskforce,<sup>127</sup> coordinated by the Joseph Rowntree Foundation, is considering these issues and their findings will be worthy of careful consideration. The taxation and subsidy system in the UK has been compared

with those in other countries by a recent study commissioned by the Taskforce.<sup>128</sup> Particular attention was paid to Denmark, Germany, the Netherlands and the USA. These comparisons highlighted a number of different taxation and subsidy options that could be effective in the UK.

## Improving standards in private renting

It is important to address the relationship between Housing Benefit and minimum standards as it has been argued that Housing Benefit can trap households in substandard accommodation. Due to the shortage of properties that are available to Housing Benefit recipients there is an imbalance of power between Housing Benefit claimants and landlords. If this is the case then Housing Benefit can become government support for market failure, supporting unscrupulous landlords. There is a particular issue with housing and minimum standards because the price of rental properties is primarily determined by location. Landlords may not recoup the outlay on improvements in standards with a corresponding increase in rents. However, a simplified Housing Benefit system would not be the best mechanism to improve standards.

This raises questions about what a reasonable standard of accommodation is. A number of different measures exist including the Housing Health and Safety Rating System (HHSRS)<sup>129</sup> (England and Wales), the Decent Homes Standard<sup>130</sup> (England, Wales and Northern Ireland), the Statutory Fitness Standard<sup>131</sup> (Northern Ireland), The Repairing Standard,<sup>132</sup> the Scottish Housing Quality Standard<sup>133</sup> and the 'tolerable standard'<sup>134</sup> (Scotland).

Other proposals to ensure minimum standards are well developed, particularly those for landlord registration outlined in the Rugg Review of the private rented sector.<sup>135</sup> Landlord registration has been in operation in Scotland for 4 years. However, the coalition government has stated that it does not intend to take forward these proposals.<sup>136</sup> Regulation will remain the responsibility of local authorities. The low level of enforcement action suggests that at the very least there is a need for better enforcement of existing standards.<sup>137</sup> This is likely to be due in part to the difficulties of enforcement where tenants have low levels of buying power and limited alternative options. Local authorities also suggest that prosecutions are expensive and one of a number of competing priorities for environmental health officers.

Given the financial constraints facing local authorities it may also be worth investigating the lessons that can be learned from regulation and enforcement of minimum standards in other industries, particularly those that deal with major health risks, as can occur in housing. These might include:

- MOTs for cars to ensure the safety of all road users and gas safety records in rented accommodation.
- The Food Standards Agency and environmental health check minimum health standards in large numbers of small takeaway and restaurant businesses. These businesses might be analogous to the situation in the private rented sector which is predominantly made up of landlords with small numbers of properties.

Whilst there are strengths and weakness with different approaches to regulation these examples help to clarify the possibilities that are available in the housing system. Adopting a more ambitious approach to develop a minimum standard for all rented housing could safeguard the wider housing system, not just Housing Benefit tenants. It could also be used to ensure adequate maintenance of properties, adding to their longevity.

# Appendices

## Participant list

BSHF is grateful for the contributions made by participants at the Consultation. This report does not claim to represent a consensus opinion of all those present, although in preparing it we have drawn heavily on the discussions held. Responsibility for any remaining errors rests, of course, with the authors.

The Consultation was chaired by **Lord Richard Best, OBE**.

### **Participants at the Consultation were:**

**Per Åhrén**, Senior Advisor, Strategic Department, Norwegian State Housing Bank

**Penny Coburn**, Head of Service, Rent Service Scotland

**Carol Dair**, Research Fellow and Director of Oxford Institute for Sustainable Development: Cities, Oxford Brookes University

**Louisa Darian**, Analyst, Resolution Foundation

**Diane Diacon**, Director, Building and Social Housing Foundation

**Marja Elsinga**, Professor, OTB Research Institute for the Built Environment, Delft University of Technology

**Julie Fawcett**, Social housing tenant and Board Member of the Tenant Services Authority

**Jon Fitzmaurice**, Director, Self-Help Housing.Org

**Frank Fletcher**, Board Member and Company Secretary of the Tenants and Residents Organisations of England (TAROE)

**James Gregory**, Research Fellow, The Fabian Society

**Rod Hackney**, Managing Director, Kansara Hackney Limited

**Sue Harvey**, Senior Consultant, Campbell Tickell

**Judith Hermanson**, Senior Fellow, InterAction

**Julie Holden**, Head of Revenues and Benefits, Tandridge District Council and past president of the Institute of Revenues, Rating and Valuation

**Peter Kemp**, Head of Department, Department of Social Policy, University of Oxford

**Sam Lister**, Policy and Practice Officer, Chartered Institute of Housing

**Andrew Morrison**, Director of Policy & Business Development, Orchard & Shipman plc

**Stephen Muers**, Head of Strategy, Homes and Communities Agency

**Michelle Norris**, Senior Lecturer, School of Applied Social Science, University College Dublin

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**Liz Phelps**, Social Policy Officer, Citizens Advice

**Ian Potter**, Operations Manager, Association of Residential Letting Agents (ARLA)

**Bill Randall**, Writer and Commentator on Housing and Community Issues

**Katharine Sacks-Jones**, Policy Manager, Crisis

**Gavin Smart**, Assistant Director – Research and Futures, National Housing Federation

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**Mark Stephens**, Professor in Urban Economics, University of Glasgow

**John Strange**, Trustee, Building and Social Housing Foundation

**Chris Town**, Vice Chairman, Residential Landlords Association (RLA)

**Jim Vine**, Head of Programme (UK Housing Policy and Practice), Building and Social Housing Foundation

**Kate Wareing**, Director – UK Poverty Programme, Oxfam GB

**Several speakers and panellists joined the Consultation. They were:**

**Mike Brewer**, Programme Director, Direct Tax and Welfare, Institute for Fiscal Studies

**Stephen Greenhalgh**, Leader of the Council, London Borough of Hammersmith & Fulham

**John Hills**, Director, Centre for Analysis of Social Exclusion, London School of Economics

**Cathy Payne**, Deputy Divisional Manager (Housing Benefit Strategy), Department for Work and Pensions

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