May 2012

Executive summary

Bricks or benefits?

Rebalancing housing investment

Housing benefit is poised for abolition after 30 years as a national welfare benefit. Government support for housing costs will instead be provided via Universal Credit, as part of the biggest shake-up of the welfare state for 60 years. Yet the central question of whether a cash benefit paid to individuals is the best way to support low and middle income households to house themselves has not been answered.

Successive governments have moved to curb the rising cost of housing benefit by adjusting benefit entitlement and imposing additional restrictions on the regime, but these efforts have focused on treating the symptoms rather than the cause.

The report sets out the argument for a preventative approach; investing in supply to bring down the housing benefit bill by reducing the cost of housing and lifting households out of the benefit trap.

Why is subsidy required?

There will always be a group of people who are unable to meet their own housing needs via the private market. Removing housing subsidies entirely would leave many pensioners, vulnerable households and those requiring a short-term safety net unable to house themselves adequately, imposing poverty on many and encouraging bad housing conditions to flourish. Economic and social policy may attempt to reduce the relative size of this group, but policy makers will always have to accept a residual level of need. Broadly speaking, such households can be divided into three groups, though in practice many people will move between these, so an overly differentiated policy response may be unworkable:

- long-term low income households, such as pensioners or those unable to work because of illness or disability
- short-term low income households, for example the recently unemployed
- working households unable to afford market housing because of high costs and low wages.

The first group is likely to grow somewhat as the population ages, notwithstanding attempts to reduce the number of people claiming long-term sickness benefits. The second has grown rapidly with the rise in unemployment, but can be expected to fall as and when the economy recovers.

More troubling is that the third group – those in work but still needing a housing subsidy – has grown rapidly in recent years as market rents have become unaffordable for households further up the income scale.

Since 2008 the number of working households in receipt of housing benefit has more than doubled and now represents 17 per cent of all claimants.[1] This is primarily driven by the disparity between wages and rents, with 55 per cent of local authority areas unaffordable to private renting households on average incomes.[2]

This summary is based on the full report that is available from Shelter's Policy library at shelter.org.uk/policylibrary

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How is subsidy provided?

Governments can chose to subsidise low income households in two main ways: by supporting demand, typically in the form of housing benefit, or supporting supply, for example by investing in sub-market housing. Both have their advantages and drawbacks, and in practice policy makers will always need to balance the two approaches. Broadly, demand side subsidies provide an immediate safety net during falls in income and enable claimants to house themselves independently via the market, or to maintain an affordable tenancy. Supply side subsidies increase the availability of housing, often at sub-market rents, and make it more likely that households on lower incomes will be able to secure accommodation within their means. More simply, subsidising housing benefit enables people to pay the rent, while subsidising supply reduces the rent they have to pay.

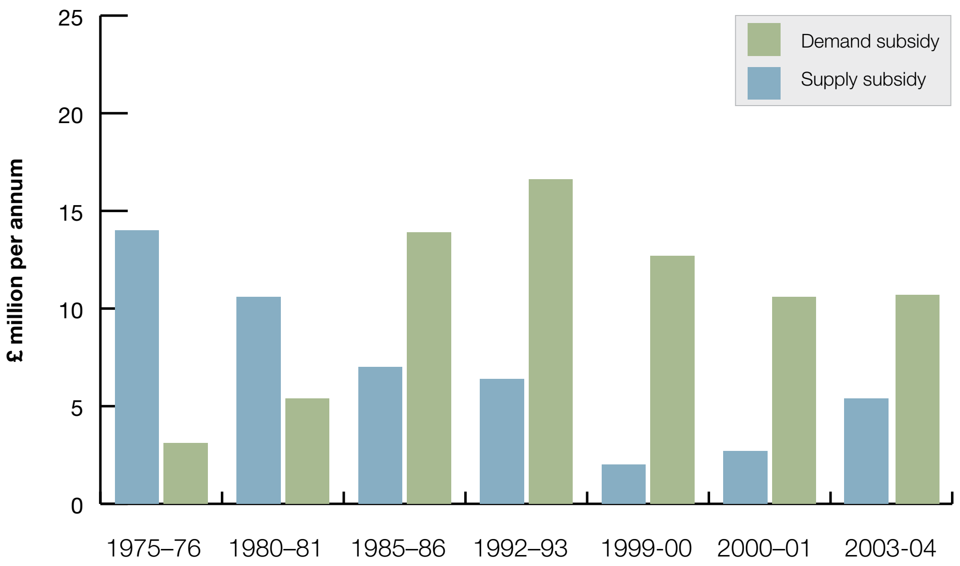
An overview of subsidies

	Pros	Cons
Demand side	Efficient – targeted only at those who need it	Some work disincentives inevitable
	Portable and encourage mobility	Can be complex
	Supports mixed communities	Lower levels of public and political support
	Flexible and immediate safety net for low income households	Success dependent on take-up
	Helps recipients to house themselves in the market	Vulnerable to price increases
	Enables greater individual choice	Little control over quality of properties or landlords
Supply side	Reduces direct cost of housing	Discourages mobility
	Reduces work disincentives and benefit dependency	Historically has led to area segregation
	Increases supply	Inefficient if supports better off tenants

Over the past forty years the balance of subsidies has tipped heavily from the supply side towards the demand side, leading to rising expenditure on housing benefit and declining investment in bricks and mortar.[3]

- The 1950s and 60s saw high levels of government investment in house building as political parties competed to promise the most new homes in their manifestos.
- In the 1970s and 80s governments concluded that the UK had a sufficient supply of housing and that subsidy should be directed to support individuals to access homes via the market.
- During the 1990s and 2000s rising rents resulted in an increasing housing benefit bill, despite repeated attempts at reform. Housing benefit spending rose and fell with the economic cycle while the underlying cost of housing continued to increase.

Figure 1: Historic trends in housing subsidy[4]



Impact of past policy trends

One in five households are now reliant on housing benefit.[5] This is not a reflection of largesse within the system but rather of underlying economic trends, high housing costs, and the fact that housing benefit is now the dominant housing policy instrument. The past forty years have seen the balance of subsidies shift from bricks to benefits, with decreasing investment in new supply and growing reliance on housing benefit to 'take the strain'.[6]

This has not been an accidental shift but sprang from a clearly articulated belief that individual support was the most efficient form of subsidy.[7] This was driven partly by a perception that decades of building since the second world war had finally resulted in there being enough homes, and partly by the belief that the market would respond to stimulated demand by boosting supply at the lower end of the market. While this picture of sufficient supply may have been true in the mid 1970s, few would claim that it remains true today; raising questions of whether a policy prescription focused so heavily on subsidising demand is the most appropriate approach.

Tenure shifts

The shift in subsidy from bricks to benefits has seen a noticeable increase in the use of the private rented sector to house low and middle income tenants. In contrast, the size of the social rented sector has shrunk, such that there are now 1.8 million households on the waiting list.[8] There is no longer sufficient affordable housing available to meet the needs of all those who need it, fuelling demand for the private rented sector.

- The private rented sector has expanded from 1.7 million households in 1988 to 3.6 million in 2010/11 and is poised to overtake the social rented sector within a few years.[9]
- Average private sector rents are £4,212 higher a year than in the social sector, with larger premiums evident in London and the South East.[10]

Due to these costs, at least a quarter of private tenants require an individual income subsidy to service market rents.[11] Even during a period of high unemployment nearly a third of these private tenants receiving benefits are in work, suggesting that many only need an additional subsidy to bridge the gap between wages and housing costs.[12]

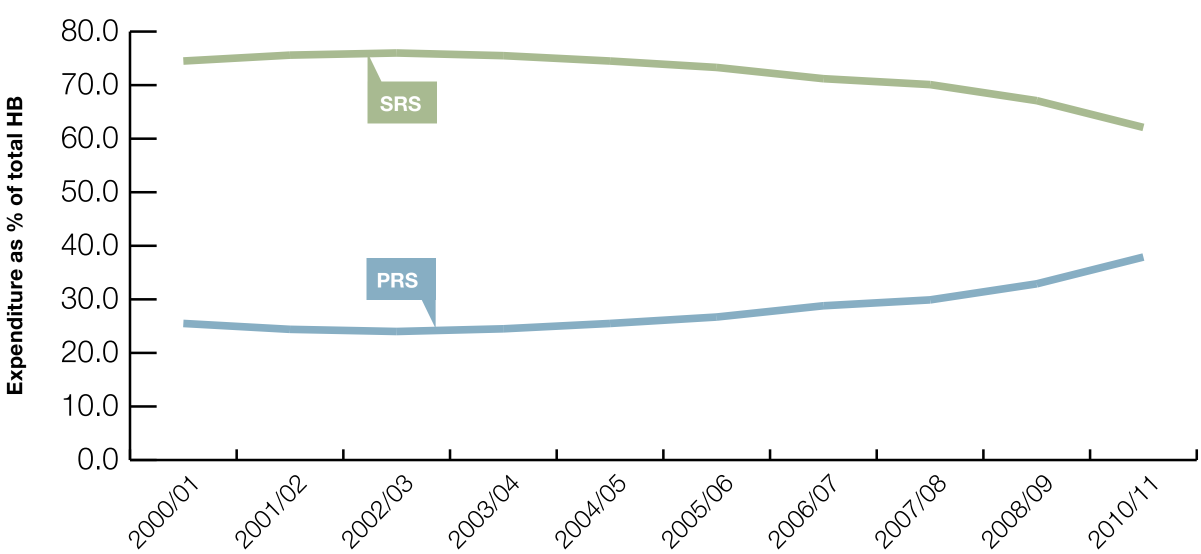
Rising costs

Housing benefit spending has nearly doubled in the past decade to an estimated £21.6 billion[13] and politicians from all parties have expressed concern at the mounting bill. Despite significant cuts to housing benefit entitlement, the Department for Work and Pensions (DWP) does not expect the overall cost of housing benefit to fall below £22 billion a year.[14] Although the level of spending has accelerated sharply following the economic downturn, it was already increasing against a backdrop of rising housing costs reflecting longer term economic drivers.

The reduced role of affordable housing goes some way towards explaining the rising bill. The number of households housed in the private rented sector has increased significantly, including those on housing benefit. This increased demand has not stimulated sufficient supply to reduce rents at the lower end of the market. Costs have instead increased, originally as a result of the move to deregulate private rents in the 1980s, and more recently as a reflection of higher house prices.

Rents have also increased in the social rented sector as a result of successive governments' policies. This has made it more expensive to support social tenants on the lowest incomes. This is likely to be exacerbated with the introduction of the Affordable Rent model, although net savings may be achieved if it enables some private tenants on housing benefit to move into the new tenure.

Figure 2: Housing benefit by tenure[15]



The persistently high cost of housing benefit across the economic cycle suggests that the bill cannot be reduced in a sustainable way until the underlying drivers of housing need are addressed. Housing benefit expenditure is heavily influenced by the underlying cost of housing. Here it is distinct from other benefits which are based on a more abstract measure of inflation and are less vulnerable to market pressures – rising fuel costs for example do not necessarily feed through into increased unemployment payments. Increasing costs in both social and private rented tenures, and a general shift towards the more expensive private rented sector, have increased average awards and raised the housing benefit bill.

Rather than addressing the problem that housing benefit pays for an increasingly expensive product, attempts to reduce its cost have historically focused on introducing restrictions on private sector claimants, such as the introduction of Local Reference Rents in 1996 and Local Housing Allowance (LHA) cuts in 2011. This approach risks increasing poverty and undermining access to the private sector, while doing little to address underlying affordability.

Alternatively, governments can try to cut benefit expenditure by reducing the caseload. Tackling underlying economic and social drivers may help to minimise the need for housing benefit, but it can never hope to eliminate the need for it entirely and demand is likely to remain high among some categories of claimant.

Claimant type	Total number	Proportion of all households on housing benefit	Expected change
Long term claimants, including:	2,614,210	53%	Ageing population will increase demand among non-homeowner retirees. Policy pressure to reduce the relative size of other groups, but expect persistent need.
Pensioners	1,072,920	22%	
Lone parents and carers	1,210,740	24%	
Sick and disabled	330,550	7%	
Unemployed typically short-term claimants	629,490	13%	Varies with economic cycles but will always exist to a variable degree.
Working claimants	865,200	17%	Likely to increase as wages and rents further diverge.

Source: DWP Housing Benefit caseload, December 2011. NB Percentage does not equal 100% because of additional non-passported claimants whose circumstances are unknown.

The divergence between rents and wages makes it more likely that lower paid workers, particularly in more expensive regions, will continue to require additional housing benefit. This means that even if welfare reform succeeds in shifting households from economically inactive benefits into employment, many will continue to require support for their housing costs via Universal Credit. Tackling economic inactivity can only ever be a partial solution to reducing benefit expenditure when housing remains expensive, as households at the lower end of the labour market will continue to be eligible for an additional subsidy.

Work disincentives

By bridging the gap between incomes and housing costs housing benefit ensures that, theoretically, low income households can afford a decent home. Such support is efficient in the sense that it can be tightly targeted at those who genuinely need it, but it can have negative implications for households who interact with the system. Income-based subsidies inevitably create a poverty trap, as the subsidy has to be withdrawn as incomes rise. This means that the returns from work or increased earnings can be minimal: as a result, housing benefit is frequently criticised for creating a strong work disincentive. This is compounded by the administrative problems which have bedevilled the housing benefit system, particularly for working tenants and/or those whose circumstances change frequently. Combined with the poverty trap, this means that entering work can be an uncertain and potentially risky move for a household that relies on housing benefit to avoid homelessness. Universal Credit is intended to alleviate some of these concerns but will not eliminate them entirely.

The poverty trap is made more acute when housing benefit supports high rents. Tenants in council housing are able to reduce their housing benefit claim to zero with relatively modest earnings, enabling them to benefit from the full returns of increased wages. In contrast, private tenants remain eligible for housing benefit at higher income levels, reducing their incentives to increase earnings further. Lower rents in the social housing sector enable low and middle income households to be independent from the benefit system while in work, while also reducing the housing benefit bill for those who still require a safety net.

Rebalancing subsidies

Increasing investment in genuinely affordable housing would:

- reduce reliance on the private rented sector for those who cannot independently afford market rents,
- cut the underlying cost of housing benefit; and
- support efforts to reduce benefit dependency.

It could bring the largest gains for low income working households able to move out of the private rented sector, where the high rents demanded by the market make it more likely they will require additional means-tested benefits to supplement their wages.

It is likely that some households would continue to require an additional housing benefit to pay even social rents, because they are on very low incomes. However, if they are housed by not-for-profit landlords some of this expenditure can be captured to support new investment in supply or stock improvements, extracting additional gain from housing benefit.

Historically the ability of housing benefit to cover actual rents at all levels in the social sector has supported long-term business planning and the development of affordable homes by housing associations. In particular, the security of housing benefit revenue streams has enabled housing associations to obtain preferential borrowing rates, making new development more cost efficient.

The arguments that made individual subsidies attractive in the 1970s and 80s no longer hold. The market has demonstrated that it cannot be relied upon to meet housing need: the problem is not just individual incomes being low relative to housing costs, but a general lack of supply driving up prices and enabling poor conditions to proliferate at the bottom end of the private rented sector. A range of indicators show that housing need is rising, while housing supply has fallen to its lowest peacetime level since 1924.

In this context it is no longer appropriate to focus interventions purely on the demand side. Forty years of this approach have led to an undersupply of genuinely affordable housing and inflated the housing benefit bill: it is now time to invest more in supply and rely less on means-tested benefits.

Re-balancing subsidies in favour of supply would deliver a lower overall housing benefit bill, reduced numbers of working households requiring support for housing costs in Universal Credit, and a greater share of benefit spend could be reinvested in new supply and improving standards. Despite these compelling arguments, successive governments have baulked at the up-front costs of shifting the focus of subsidies back towards supply, deferring long-term investment in favour of short-term reliance on housing benefit.

The average grant from the Homes and Communities Agency for an affordable home was £60,000 before the introduction of an Affordable Rent model[16], based on which it would take approximately 30 years for reduced benefit expenditure to compensate for the up-front cost of investment.[17] This is beyond the appeal of a five-year election cycle, even if inaction carries significant long-term costs. But it is not beyond the scope of development finance markets, which traditionally price housing investment over periods of 30 years or more. Over these timescales, investing in new supply can pay for itself out of benefit savings alone.

There is now wide-spread agreement that more supply is desperately needed to avoid long-term dysfunction in the housing market. Research commissioned by Shelter estimates that approximately 240,000 new homes a year are required to meet projections. Within this, nearly a third should be social housing to meet newly arising need and demand.[18] There is also a backlog of approximately 500,000 existing households who would benefit from truly affordable housing. As well as meeting housing need, such an approach would bring wider economic benefits with every £100 spent on house building generating £350 in return.[19]

Shelter will continue to press the case for government-led investment in new supply, as historically this has been the deciding factor in determining the overall level of supply in all tenures. We do not underestimate the difficulty of this task: investment in new housing was cut by over 60 per cent in the last spending review and there are few signs that Government will commit to the investment necessary in the short to medium term.

But changes in the Localism Act such as the housing revenue account (HRA) reform, the empty homes initiatives, and even proposals such as charging market rents for higher-earning social tenants, do provide new opportunities to leverage existing stock for new supply. In the current economic climate it is also appropriate to consider whether more creative models of investment could stimulate supply.

Investing in new supply would no longer be viewed as such an expensive outlay if policy makers better understood that capital investment and housing benefit spending are interlinked. The challenge for Ministers is to think less like politicians focused on populist benefit cuts and short-term savings, and more like business people working towards a long-term investment plan.

As past decades have demonstrated, short-term savings on capital expenditure are likely to result in long-term pressures on housing benefit unless other policies can translate into sufficient supply to reduce costs at the lower end of the market.

Shelter encourages reforms to simplify the benefit system and make work pay. Support for housing costs will be a vitally important part of Universal Credit and must be set at a level that ensures households can access decent, affordable housing.

Initiatives to help households into work where they are able are welcome and will go some way towards reducing housing benefit expenditure as incomes rise. But welfare reform alone will not address the needs of households who only require support because local housing and employment markets are out of step. It is in their interest, and those of tax payers, that housing benefit reverts to being a safety net rather than a long-term crutch propping up a dysfunctional housing system.

Footnotes

[1] Department for Work and Pensions (DWP), housing benefit (HB) and council tax benefit (CTB) caseload tables, December 2011.

[2] Reynolds, L, *Shelter Private Rent Watch*, Shelter, 2011, see shelter.org.uk/policylibrary

[3] Hills, J, *Ends and Means: The future roles of social housing in England*, 2007.

[4] ibid, 2007, Table 6.1.

[5] 4,909,510 households claim housing benefit (DWP figures: August 2011) out of approximately 26,148,000 households in Great Britain, Communities and Local Government (CLG), Table 401: Household projections, UK, 1961–2033.

[6] Sir George Young MP, House of Commons debate, 20 October 1993.

[7] Department of Environment, *Fair Deal for Housing white paper*, 1971.

[8] CLG, Live table 600, 2011.

[9] CLG, *English Housing Survey Headline report 2010–11*, figure 1, 2012.

[10] CLG, *English Housing Survey: Household report 2010–11*, 2012.

[11] ibid. NB survey data tends to underestimate benefit claimant levels.

[12] House of Commons, 25 November 2011, c638W; DWP, HB and CTB caseload tables, August 2011.

[13] DWP, Benefit expenditure tables, 2011.

[14] ibid.

[15] Pawson, H, and Wilcox, S, *UK Housing Review 2011/12*, Table 122, Chartered Institute of Housing (CIH), 2012.

[16] Homes and Communities Agency (HCA), *Corporate Plan 2009/10–2010/11*, September 2009.

[17] The average annual housing benefit claim for a council tenant is more than £2,000 lower than for private tenants. See Pawson and Wilcox, 2012, Table 118.

[18] Holmans, A, Monk, S, and Whitehead, C, *Homes For the Future*, Shelter, 2008.

[19] Lindsay, D, *Research Briefing: Housing Investment Part 1*, Shelter, 2010, see shelter.org.uk/policylibrary

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