Research briefing

The relationship between Local Housing Allowance rates and rents

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Shelter

Shelter regularly witnesses the impact of the freeze to Local Housing Allowance (LHA). While the LHA rates have been frozen, private rents have continued to increase, rendering much of the country unaffordable for those receiving help in paying their housing costs. Households are left with unmanageable shortfalls between their housing support and rent, driving many into debt and some into homelessness.

The reform and subsequent freeze to the LHA was in part driven by a belief that increases in rental subsidies such as the LHA may drive rental inflation. Government viewed the mounting housing benefit bill through this lens, and it remains an argument made against significantly uprating LHA rates once the freeze comes to an end in 2020.

This report assesses the evidence of the relationship between rental subsidies such as the LHA and local market rents. When looking specifically at the reforms since 2011 it finds that there is little evidence to suggest a significant relationship in the UK housing market. This review underlines the fault in concluding that there is a sub market of the private rental sector across England in which the LHA plays a significant role in setting rents.

Evidence on why this might be the case is presented, including differences in landlord and tenant behaviour to the specified model, and the market diversity within England.

Economic theory and evidence

Economic theory suggests that rent subsidies, such as the Local Housing Allowance, can distort the market, allowing landlords to set higher rents in response to increases in the rate at which the allowance is set[1]. This belief, and the potential for self-perpetuating rent inflation drove some of the adjustments we have seen in the delivery of the LHA in the last 8 years.

In evidence to a Work and Pensions Inquiry on the Budget 2010 reforms the Welfare Reform Minister stated: *"We took the view that we have to break this feedback loop of us pumping in money that pumps up the amount of money we have to pay"*[2]

The Minister cited evidence that between November 2008 and February 2010 the average rent paid to LHA claimants increased by 3%, whilst in the wider (non-housing benefit) market average rents fell by 5%[3]. This finding led to the conclusion that landlords letting to recipient households were price setting according to the LHA rates rather than following the wider market.

The rapid increase in government expenditure on Housing Benefit (HB) created an incentive to act to constrain the cost. Between 2000/01 and 2010/11 the HB bill increased in cash terms

[1] Institute for Fiscal Studies (2014*) Econometric analysis of the impacts of Local Housing Allowance reforms on existing claimants*
[2] HC(2011) Oral Evidence, Ev 25, Q132
[3] Ibid

from £11 billion to £22 billion[4]. However, the rising bill was not solely driven by increases in the cost of rents. A combination of the financial crisis and the beginning of the programme of austerity led to a 51% increase in the number of privately renting housing benefit claimants in England in just three years[5].

Analysis from the Chartered Institute of Housing (CIH) also found that inflation in the average rent levels that were being paid out from Housing Benefit in the period prior to March 2011 was "entirely due to changes in the caseload composition"[6], rather than landlords 'gaming' the housing benefit system

Their analysis showed that the inflation of the average rental award was due to claimants moving from areas where rents were relatively inexpensive (such as the North and the Midlands), to more expensive areas (London and the rest of Southern England). This increased the cost of the average award given to recipient households. A shift in the composition of households receiving assistance from single person households to a higher proportion of families also caused some of the uplift.

The changes to LHA from 2011 reduced the level of rents met by HB by decreasing the percent of the market that rates covered from 50% to 30% and aimed to apply downward pressure on expenditure more generally i.e. to reduce rents in certain areas[7]. Evidence for this impact is however lacking when looking at recent HB policy and its effect on local markets. Price setting in rental markets is highly complex, and with the rapid expansion of the private rental sector over the last decade, and declining social housing, the current market is substantively different now than it was even twenty years ago.

A review of existing evidence shows that the impact of rental subsidies on rents are not easily generalised across markets, with the effects dependent on the details of the individual private rental market. Much of the empirical evidence linking rent subsidies with rental inflation was not conducted in the United Kingdom (UK) context, or within the current, much changed market. Indeed, the last major change to the benefit system within the UK that drove several academic studies was in the mid-1990s, when just 9.6% of households in England were privately renting, in comparison to the 19.5% in 2017-18[8]. Given these changes to the private

[4] Department for Work and Pensions (2011) *Housing benefit – uprating local housing allowance rates by CPI from April 2013*

[5] Stat-Xplore: In November 2008 there were 938,183 privately renting housing benefit claimants. This increased to 1,413,712 by November 2011.

[6] Chartered Institute of Housing (2011) *Leading the market? A research report into whether Local Housing Allowance (LHA) lettings are feeding rent inflation*

[7] Department for Work and Pensions (2011) *Housing benefit: Uprating Local Housing Allowance by the Consumer Price Index*

[8] Ministry of Housing, Communities and Local Government (2019) *English Housing Survey 2017-18: Headline report*

rental market the relevance of previous empirical work when estimating how LHA reforms will impact on rents may be limited[9].

Impact on rents of recent changes to HB delivery

Evaluation of recent evidence suggests that local markets have not responded to policy changes in line with this model. The same theory that suggests that increases in rent subsidies should be largely incident on the tenant (i.e. through them paying higher rents), states that cuts to subsidies as carried out in 2011 and beyond should largely be incident on the landlord (i.e. through reduced rents)[10].

Research carried out on behalf of the Department for Work and Pensions (DWP) using administrative data shows that this has not been the case. This review assessed the impact of changes to the design of the LHA from April 2011 to December 2012. These reforms included:

- Setting LHA rates at the 30th percentile of PRS rents rather than the median (50th percentile)
- Removal of the £15 per week excess
- Abolition of the five bedroom LHA rates
- Capping the LHA rates
- Extension of the Shared Accommodation Rate to include most single adults without dependent children aged 25-34 not living in shared accommodation.
- Increase in funding for Discretionary Housing Payments.

The analysis concluded that when the maximum LHA entitlements were reduced 94% of the incidence of the reforms was on tenants, while just six per cent was on landlords[11]. Further analysis on behalf of DWP estimated that 89 per cent of the reduced LHA entitlements was on tenants and 11 per cent on landlords[12]. For every pound reduction in entitlement, tenants were having to make up 89-94 pence. This has put many at immediate risk of hardship as the shortfalls between the LHA rate and rents grow further.

The relationship between the LHA and private rents has been over-simplified in the current discourse, with many assuming a direct causal link between the two. The failure of cuts and reforms to the LHA to be largely incident on the landlord indicates that the relationship is more complex than specified.

[9] Institute for Fiscal Studies (2014) *Econometric analysis of the impacts of Local Housing Allowance reforms on existing claimants*
[10] IBID
[11] Department for Work and Pensions (2013) *Monitoring the impact of changes to the Local Housing Allowance system of Housing Benefit: Interim report*
[12] Institute for Fiscal Studies (2014) *Econometric analysis of the impacts of Local Housing Allowance reforms on existing claimants*

Factors affecting rent setting

The following factors may in part explain why changes to the delivery of LHA have largely been incident on tenants rather than landlords. Looking forward many of these may be relevant when assessing the likely impact of changes to the rates on rents following the end of the LHA freeze in 2020.

Tenant behaviour

Tenants do not always react to changes in their entitlement as theory suggests. In this case lower levels of housing support should encourage them to seek accommodation in cheaper areas, or to negotiate on their rents with their landlord. However, income is not the sole determinant of demand for tenants[13]. Tenants also place value on remaining in areas of high housing cost, to be closer to places of work, and are less able to move due to the costs of moving away from either support networks, or employment opportunities. Tenants in receipt of the LHA may therefore have accepted high and increasing shortfalls between their housing support and housing costs, to remain in areas that they perceive to have economic or social value to them.

Tenants may also face other barriers to moving, including the high costs of financing an additional upfront deposit, paying letting fees and moving costs[14]. The availability of alternative more affordable or suitable accommodation may also be an issue, particularly given competition for available homes and 'No DSS' discrimination. Shelter's research found No DSS discrimination prevalent across a sample of letting agents operating in England[15]. The mystery shopping found that five out of six of the letting agent brands had an outright band on renters on housing benefit in at least one of their branches. Shelter's analysis also showed that almost half (48%) of all branches called had no properties available for people on housing benefit.

Tenants were also unlikely to attempt to renegotiate rents following the implementation of the reforms, limiting their impact. Most claimants (77%) did not attempt to renegotiate their rent, potentially because of concern about losing their property in areas of high demand[16].

The wider market

Private landlords do not often operate solely in an isolated HB market, in which prices are determined by the LHA rate. The concept of a large sub-market of the private rental sector in which prices are determined by the LHA rate is central to the economic theory. However, Shelter's survey of landlords shows that they are most likely to either prefer not to let to

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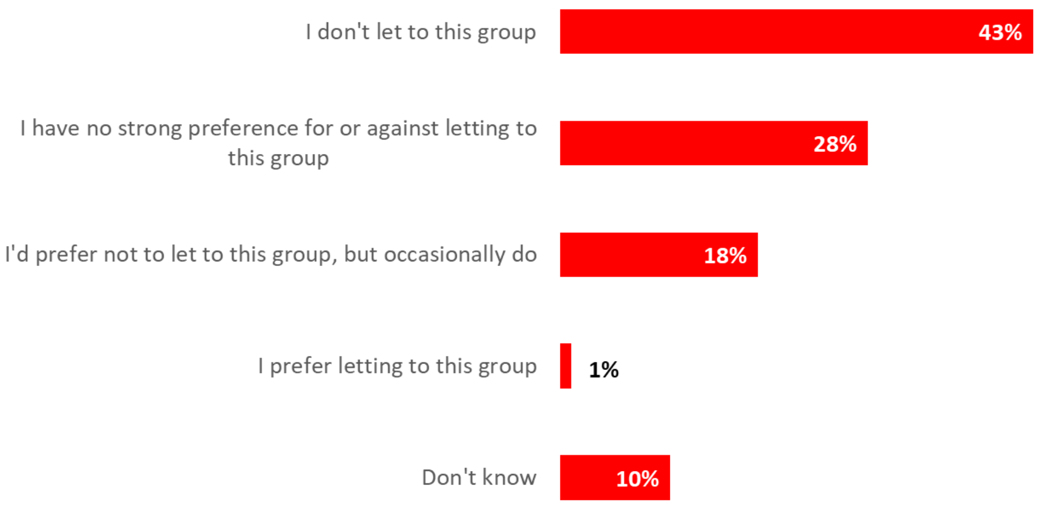
[13] Sanderson, Elizabeth and Wilson, Ian, Does Locality make a difference? The impact of housing allowance reforms on private landlords (2017). Housing Studies, 32(7)
[14] Shelter (2016) *Green Book 50 years on. The reality of homelessness for families today*
[15] Shelter (2018) *Stop DSS Discrimination – Ending prejudice against renters on housing benefit*
[16] Department for Work and Pensions (2012) *Monitoring the impact of changes to the Local Housing Allowance system of housing benefit: Summary of early findings*

claimants at all, or to be competing to place tenants from both claimant and non-claimant households within their properties. This may mitigate the price setting power of the LHA rate, with local housing market conditions and, specifically, alternative sources of demand cited as the primary reason for a lack of renegotiation on rents following the LHA changes[17]. In areas of high house prices for instance, households locked out of home ownership are likely to provide significant competition for all properties within the PRS.

Shelter's research with landlords shows that generally landlords do not look to specifically rent properties to households claiming HB. Just one per cent of landlords prefer letting to claimants and over four in ten (43%) will not let to claimants at all. Rent setting behaviour amongst landlords is therefore unlikely to solely target households claiming the LHA rate.

In general, which one of the following best describes your policy on letting to Local Housing Allowance / HB claimants



Base: 1,137 private landlords. Source Shelter Private Landlord Survey 2017

Households claiming housing support also make up the minority of households across most local authorities in England. In four in ten (44%) authorities under 20 per cent of the private rented dwelling stock is occupied by claimant households. This rises to over seven in ten (72%) of authorities when increased to under 30 per cent.

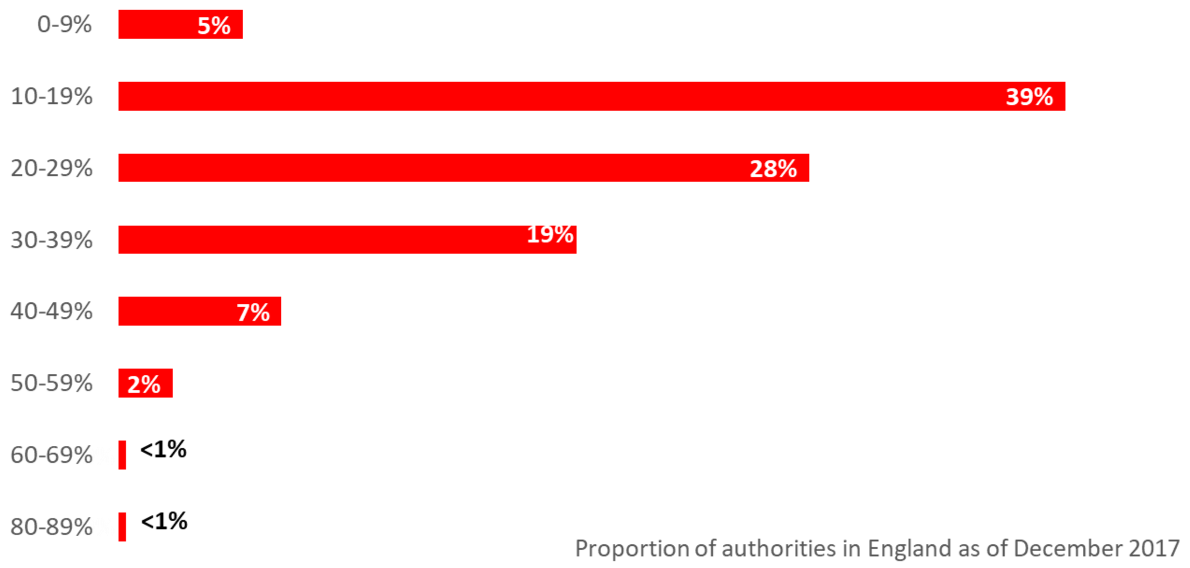
Local markets where claimant households are a small minority are likely to be less impacted by any change in HB policy. In these areas changes to LHA rates are less likely to have a direct effect on market rents as a whole. They are also less likely to develop a substantial LHA sub-market. Shelter's analysis shows that most markets across England are not dominated by housing benefit households. HB claiming households make up just 0-19% of the privately rented stock in the plurality of areas.

[17] IBID

Clearly, changes to rate setting for the LHA will impact some markets more than others, with the rental market more likely to be heavily affected in areas such as Blackpool[18]. Here an authentic 'market rent', independent of the LHA sub-market, arguably does not exist, given 81% of the privately rented dwelling stock is occupied by households in receipt of housing support. However, this level of market dominance by claimant households is rare across England. Less than four per cent of authorities have more than 50% of the PRS market made up of claimant households.

Across the country there is likely to be no significant relationship between the proportion of households claiming housing support and rent inflation. Research from CIH highlights this point. They found that "at best only 2.1% of the variation in rent inflation is due to the proportion of the market that is let to housing benefit claimants"[19]

Proportion of households claiming housing support within a local authority



Source: Stat X-plore- Households receiving the housing element of Universal Credit and number of HB claimants that are private deregulated tenants (LHA). ONS Subnational dwelling stock by tenure estimates.

Landlord Trade-offs

Landlords face trade-offs when resetting rents following extensions or renewals of tenancies. They do not always seek to increase rents, instead some prefer to keep the rents the same to maintain a tenancy. By maintaining a tenancy, the landlord avoids losses of rent during periods the property may be unoccupied while searching for a new tenant. Landlords may also be concerned about the costs associated with reletting, such as any check out reports, referencing, or advertising.

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18 Civitas (2015) *The Future of Private Renting Shaping a fairer market for tenants and taxpayers*
19 Chartered Institute of Housing and British Property Federation (2011) *Leading the market? A research report into whether Local Housing Allowance (LHA) lettings are feeding rent inflation*

Landlord's self-reported behaviour suggests that when they do renew or extend a tenancy they are more likely to keep the rent the same, rather than increase it. Two in three (66%) landlords who renewed or extended a tenancy in the last five years say they kept the rent the same[20], one in three (31%) increased the rent by a little. Any increase in rental income may be more than offset by the risk of a higher turnover of tenants, introducing the potential for void periods and reletting costs[21],The rate at which landlords end tenancies in order to increase rents is unlikely to be significant driver of increases in market rents. Landlords self-reported behaviour shows 3% of tenancies are ended to relet at a higher rent[22].

Landlord costs

Shelter's research with private landlords[23] who rent to claimant households shows that their rent setting behaviour is mainly impacted by changes to their own costs, rather than external factors. One in four (23%) say that the main reason they plan to increase the rent is because of increases to their general costs, 15 per cent say it is to cover the costs of renovation / redecoration, and 12 per cent say it is to offset changes to mortgage interest relief changes. Just one in five (19%) say that it is because the 'market is going that way in the area'.

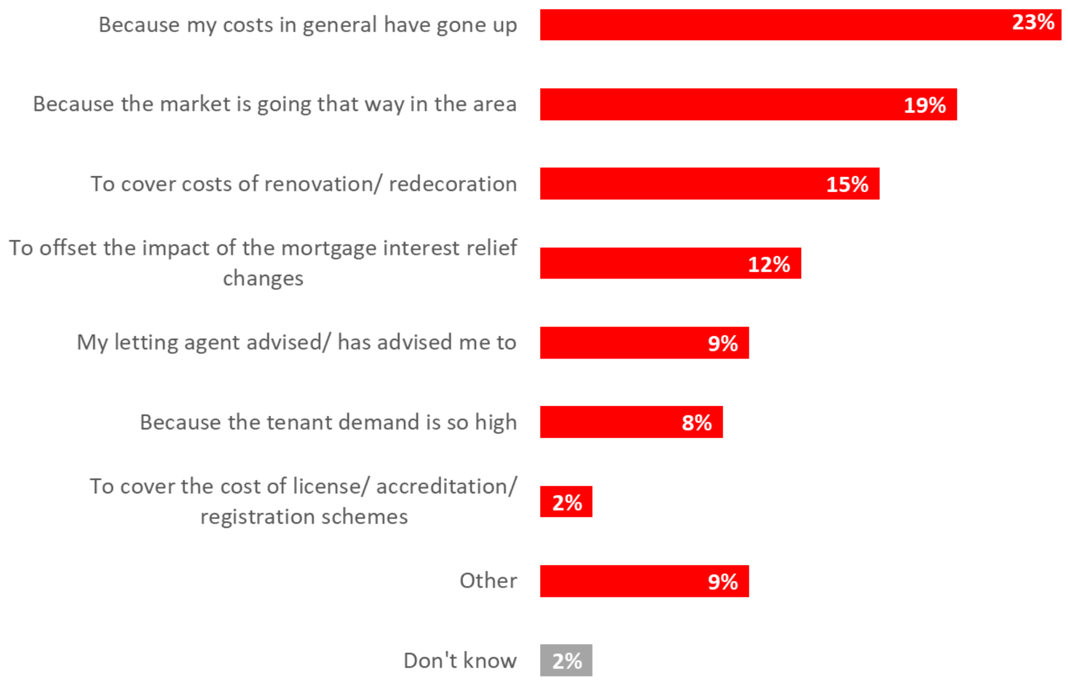
And which of the two reasons you chose would you say is the main reason why you increased the rent?

[20] Shelter Survey of Private Landlords 2017

[21] Department for Work and Pensions (2014) *Monitoring the impact of recent measures affecting Housing Benefit and Local Housing Allowances in the private rented sector – The response of landlords*

[22] Ministry of Housing, Communities and Local Government (2019*)* *English Private Landlord Survey 2018*

[23] This research was conducted with a small sample of 86 private landlords so should be treated with some caution.



Base: 86 private landlords who have a tenant on HB and will increase their rent the next time one of their properties becomes vacant. Source Shelter Private Landlord Survey 2017

Reforms to come

From April 2020 the freeze to the LHA rates will come to an end. Despite economic theory suggesting otherwise the reforms to the rates since 2011 have largely been incident on tenants. This has resulted in households facing substantial monthly shortfalls, putting them at risk of hardship and homelessness as they struggle to maintain their tenancy.

When reviewing changes to the LHA from April 2020 it should be accepted that the theory that there is a direct and strong causal link between LHA rates and rent inflation is based on over-simplified assumptions. This thinking ignores the existing evidence, the range of behavioural responses of both tenants and landlords, as well as the diversity and complexity of local markets.

Landlords make trade-offs when thinking about increasing rents. Many landlords may prefer to keep avoid the risk of losing rental income during void periods, and the costs associated with reletting. They do not solely base their rents on the local market, instead, they are most likely to change them due to changes to their own costs. The preferences of landlords also play a role, with landlords unlikely to specifically aim to rent to people receiving housing support, instead preferring to operate in the full market. A logical decision considering claimant households make up a small minority in most local authorities.

The assumption of a significant feedback mechanism between LHA rates and rent inflation is unproven by the existing evidence. This argument must not remain a barrier to helping the thousands of people struggling with their housing costs due to the current inadequate level of LHA rates.