Can the changes to LHA achieve their aims in London's housing market?

A report by New Policy Institute for Shelter

This report was written by New Policy Institute. It was commissioned by Shelter with funding from Trust for London. The content and the opinions within this report are attributable to the authors alone, Hannah Aldridge and Peter Kenway of New Policy Institute.

1. Overview

Aims

The aim of this study is to explore the impacts of the changes to Local Housing Allowance (LHA) introduced by this government within the context of London's higher housing costs. The changes we look at are:

- The lowering of LHA rates from the median to the 30th percentile of local rents (in 2011).
- The introduction of a national LHA cap (from 2011) which in practice only affects Inner London.
- The reduced annual up-rating of the LHA rates: in line with CPI inflation (from 2013) and just 1% (in 2014 and 2015) in all but the most over-stretched markets.

We focus on the impact of these policies on three things in particular:

- Disposable household income;
- Increased work incentives (a stated aim by the government of the changes); and
- Spending on housing benefit (another stated aim by the government of the changes).

From this analysis we draw the following conclusions:

Disposable income

1. Lowering LHA rates always makes a household worse off as measured by its disposable income after housing costs. This cut in income persists as hours of work and earnings increase until the point when the household would have 'floated off' housing benefit (HB) before the rate was lowered.
2. London's high rents mean that many households cannot work enough hours to reach this point and so neutralise the cut. For lone parents and couples with children, even full-time work at the London Living Wage is not enough. The lower LHA rates do not just cut the income of those doing little or no paid work but also most low earning households in London's private rented sector. The national LHA cap can leave those working full-time below the poverty line.
3. Households could counter the effect of an LHA cut by moving to homes that charge rent within the lower LHA rate. But demand for these properties outstrips supply so this will only be an option for a minority of those affected. As LHA rates have not kept pace with market rents, finding accommodation charging rents at or below LHA in London is increasingly difficult.
4. Universal credit (UC) raises the disposable income for those doing some work. For single young adults, lone parents with one child and a couple with two children, the increase can be around £40, £55 and £65 a week respectively. Where the cut in income from the lower LHA rate is small, these increases in income from UC can more than compensate. This only applies to working households.
5. In London cuts to LHA are greater, in particular when the national LHA cap is applied. For many households in London, UC is unlikely to counter the impact of the LHA cut, regardless of how much work is done. As a result of the lower uprating of the LHA rates,

the 'reach' of the national cap is spreading: for two bedroom properties it has increased from two of London's broad rental market areas in 2011 to five in 2014.

Work incentives

6. Lower LHA rates do nothing to improve the incentive to enter paid work. The national LHA cap undermines the work incentive provided by the overall benefit cap.
7. In itself, UC creates a significant incentive to enter paid work, notably into mini-jobs of just a few hours a week. UC helps achieve one of the government aims where the lower LHA rates do not.
8. The lower LHA rates can change the incentive to do more work. This occurs because with a reduced housing benefit entitlement a household 'floats off' HB earlier.
9. As London rents are so high even when LHA is limited to the 30th percentile, neither lone nor couple parents working full-time at the London Living Wage float off HB. The gain of a higher incentive to work in principle is never realised in practice in London.
10. Because of its lower taper, UC means that earning and hours have to be higher before the increased incentive from the lower LHA rates takes effect. This means the increased work incentives resulting from the lower LHA rates are even less likely to have an impact in London.

Government savings

11. Both the lower LHA rates and the national LHA cap save the Government money. The associated cuts in benefit are greatest in larger properties and for those in higher cost areas.
12. The saving from the national LHA cap is less than when it was introduced because the overall benefit cap now achieves many of those saving.
13. UC costs the Government money but in itself makes no difference to the savings Government makes from the LHA changes.
14. The LHA changes provide no reason for Government to bear down directly on rental levels. If rents rise, the Government is sheltered from paying higher housing benefit, leaving tenants as the sole agents of change and bearing the full consequences.

Practical conclusions

The LHA changes and overall household benefit cap have clearly cut central Government's liability to pay housing benefit. It is not clear how far these changes are able to control costs in the private rented sector. But the damage in living standards is clear and the improvements in incentives do not in practice materialise. In addition, the improved living standards from UC are likely to be overwhelmed in London as a result of the LHA changes. We conclude that the use of the benefit system to control housing costs has reached its limit.

The obvious alternative is the expansion of the social rented sector. Social rented accommodation is the optimum scenario on all three of our criteria: the work incentive is greatest, the cost to the State is lowest and the disposable income of working households is highest.

In the meantime, we recommend the abolition of the national LHA cap on the grounds that it interferes with the incentive to enter work provided by the overall benefit cap. The pressure placed on excessively high HB is anyway achieved via that overall cap. We also recommend that the overall benefit cap should be adjusted to account for the household size. At present, a workless couple with two children is entitled to less housing benefit than a workless couple with none. Lastly the process by which LHA is uprated should be revisited, to ensure that both the State and the claimant have an incentive to contain increases in rents.

2. Context

Research aim

The aim of this study is to explore how far the changes to local housing allowance (LHA) introduced by this Government are:

- controlling and reducing the overall cost of housing benefit;
- addressing the disincentives to work created by high rates of housing benefit; and
- holding down excessively high rates of housing benefit

In particular we focus on how their impact differs in London where housing costs are much higher than average.

The LHA changes

LHA is the maximum amount of rent a private sector tenant can claim housing benefit for. Any rental cost in excess of the LHA level is not eligible for housing benefit and must be met by the tenant through other means. The LHA rate applied depends on the bedroom requirements of the household: from shared accommodation, 1, 2, 3 and 4 bedroom properties.

Before April 2011 LHA was limited to the median level of local market rents (i.e. half of local properties charge rents above this level and half below). "Local" refers to properties within the broad rental market area (BRMA). Officially a BRMA is an area where a person could reasonably be expected to live taking into account access to facilities and services for the purposes of health, education, recreation, personal banking and shopping. London contains 14 BRMAs.

The three changes to LHA that this study explores are:

1. ***The lowering of LHA rates.*** From April 2011 the LHA rates were lowered to the 30th percentile of local rents (i.e. 30% of rental properties in the BMRA charge rents below this level and 70% charge rents above it).
2. ***The introduction of a national LHA cap.*** From April 2011 LHA could not exceed £250 per week for a one bedroom rising to £400 for a four bedroom property. It is only in Inner London where these national caps apply, in all other areas the local LHA rates are lower.
3. ***The way that LHA is up-rated annually.*** Previously LHA rates were re-set monthly in-line with fluctuations to local rent levels. From April 2012 this became an annual adjustment. In April 2013 they were up-rated by either the new 30th percentile level or the old 30th percentile plus CPI inflation – whichever was lower. In April 2014 and 2015 they will be up-rated by a maximum of 1% in all but the most over-stretched markets.

According to DWPs own Impact Assessments[1] these changes:

- control and reduce the overall cost of housing benefit

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214327/lha-impact-nov10.pdf and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220180/hb-lha-cpi-uprating-wr2011-ia.pdf

- address the disincentives to work created by high rates of housing benefit
- prevent those receiving housing benefit from choosing to live in properties that would be out of the reach of most people in work
- address excessively high rates of benefit paid to some people

Report structure

This paper looks at these three LHA changes (the lower LHA rate, the national LHA cap and the up-rating LHA) with a particular focus on London where housing costs are much higher and have grown at a faster rate. We will consider to what extent these policies achieve their goals within London's housing market.

Along with looking at the Government aims of (a) improving work incentives and (b) reducing the costs to the State, we will also consider the impact on (c) the wellbeing of individual households (as measured by household income after housing costs).

This report proceeds with 6 chapters of analysis which explores the following research questions:

1. How achievable is it for private renters claiming housing benefit to find accommodation within the cheapest 30 percent of properties across London?
2. In theory, how can lower LHA increase the incentive to work and reduce government expenditure on housing benefit; and how does this impact on a household disposable income?
3. To what extent does the impact of the lower LHA rates vary, given London's higher housing costs? Again this focuses on the impact on incentive to work, Government expenditure and household disposable income.
4. How does the LHA up-rating alter the impacts over time?
5. How does the introduction of universal credit alter the impact of the LHA changes?
6. How does UC alter the impact of the LHA changes given London's higher housing costs?

3. Living within the LHA rates in London

The incentive to find low cost accommodation

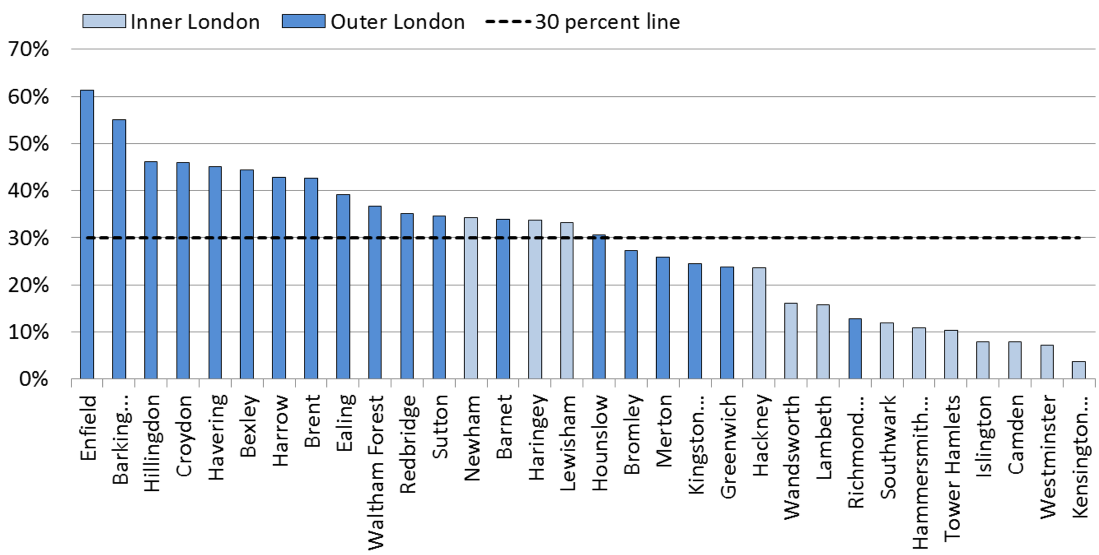
LHA is the maximum amount of rent a private sector tenant can claim housing benefit for. If a household claims housing benefit for a property with a rent above the LHA rate they have to cover all of the additional rental cost without help from the State. But in the same way, if they claim housing benefit for a rent level below the LHA rate, the State will not give them an additional housing benefit and they are no better-off for having a housing cost below their LHA. So the additional cost from having a rent level in excess of LHA falls entirely on the household but the reward of having a rental cost below LHA goes entirely to the State in reduced housing benefit payments.

Reducing LHA rates to the 30th percentile from the median creates an incentive for housing benefit claimants to reduce their housing costs to the lower LHA amount (although not any further below that level). Any household claiming housing benefit above the LHA can either see a cut in the amount of housing benefit they are entitled to (to the new LHA level) or move to one of the 30% of properties in the local area with rents below this level.

Supply and demand for low cost accommodation in London

Within London there are 14 broad rental market areas (BRMAs) each with their own LHA rate of the 30th percentile of local rents. In some of London's 14 BRMAs the 30th percentile level exceeds the national LHA cap so the latter is applied (for a two bedroom property the national LHA cap applies in 3 BRMAs: Central, Inner North and Inner East London). In these BRMAs fewer than 30% of private rented properties charge rents below the LHA cap.

How easy is it for a household in London with a rental cost above their LHA to find alternative accommodation within it? The graph below focuses on LHA claimants entitled to a two bedroom property (in August 2013) and shows them as a proportion of all two bedroom private rented households (from the 2011 Census) in each borough.



It shows that in 17 boroughs the proportion of LHA claimants for two bedroom properties accounts for more than 30% of the two bedroom private rented stock. In 8 boroughs it is higher than 40%. The boroughs with the lowest levels are those where the national LHA cap is applied so fewer than 30% of homes would charge rents within the limits.

Summary

Lowering LHA creates an incentive for claimants to reduce their housing costs to the 30th percentile level. But it is not feasible for all affected households in London to do this. Just because *some* affected households will be able to find accommodation within the lower LHA rates it doesn't mean that *all* of them can.

In the case of those entitled to housing benefit for a two bedroom property in London, even if *all* properties charging rents below LHA were occupied by claimants, in 17 boroughs some claimants would have to live in properties charging rents above LHA. Those households unable to find accommodation within LHA rates are liable to cover the excess housing costs in full without State help, regardless of the availability of suitable alternative.

4. The theoretical benefits of the LHA changes

Aim

In this chapter we explore theoretical impacts of lowering LHA. We do this by modelling the change on a hypothetical household. The aim is to understand why the government claims that lowering LHA increases the incentive to work and reduces expenditure on housing benefit. We also look at how it impacts on disposable household income.

Methodology

To understand these 'theoretical' impacts we take a simple household example – a single adult household (aged 35). We look at how their situation changes as they increase the number of hours worked per week from 0 to 35 at a pay level of £7.65 per hour (the National Living Wage). The effect of increasing work is shown under three different housing cost/LHA scenarios:

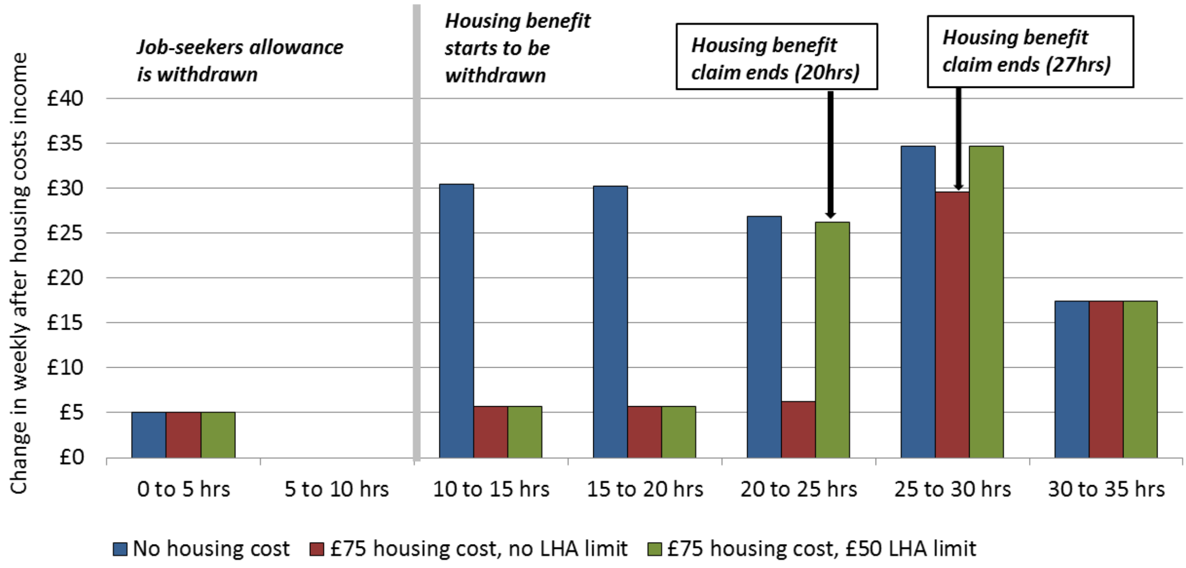
1. no housing costs (blue in the graphs to follow)
2. housing costs of £75 per week and unlimited LHA (red)
3. housing cost of £75 per week and an LHA of £50 per week (green)

The housing costs and LHA level used here are arbitrary and for illustrative purposes. In the following chapter we take a similar approach of modelling the impact of LHA on households, but we vary the type of household and their housing costs to be more representative of LHA claimants in London. In this chapter we use this simple household to look at the theoretical impact of lowering LHA on each of the following in turn: the incentive to work, disposable household income and government expenditure.

Increasing the incentive to work

Workless families and those earning small amounts are entitled to housing benefit to help them meet their rent payments. As earnings increase this benefit income is gradually withdrawn at a taper of 65% until they cease claiming housing benefit altogether. This taper lessens the incentive to work: it means that an individual's income increases by less than it would if they were not claiming housing benefit. If housing benefit entitlement were lower (which in this case is achieved by lowering LHA rates), an individual's housing benefit claim would stop at a lower earnings level, at which point the gains of working more increase.

This is demonstrated in the figure below. It uses the household example under the three housing cost/LHA scenarios outlined above. The bars in the graph show the additional income gained from working 5 more hours per week at £7.65 per hour.



Firstly, any workless single adult is able to claim job-seekers allowance. When they enter work the first £5 earned is disregarded by the State. From then on a pound of job-seekers allowance is withdrawn for every pound earned. This is why the graph shows income increases by £5 under all scenarios when 0 to 5 hours of work is done (the income disregarded) and £0 when going from 5 to 10 hours. After job-seekers allowance is completely withdrawn (when 10 hours of work is done) housing benefit starts to be withdrawn at a rate of 65p for every extra pound earned.

The blue bars show how disposable income increases as the number of hours worked increases and no housing benefit is claimed (housing costs are zero). This is the maximum disposable income that can be gained from working more as housing benefit is not withdrawn. (NB: the gains from working more still fluctuate as hours increase due to payments of council tax, national insurance contributions and income tax.)

The red and green bars show how the situation differs when housing benefit is claimed. The 10 to 20 hours part of the graph shows that claiming housing benefit makes the gains of working more hours much less (the blue bars are much higher than the red and green). But what difference does reducing housing benefit entitlement make?

Both the red and green bars show a housing cost is £75 but the green bars show the impact of a housing benefit limit of £50 so the housing benefit claimed on the green bars is £25 less than the red bars show (i.e. red is before LHA was lowered and green is after).

In both cases housing benefit begins to be withdrawn once 10 hours of work is done. When the housing benefit claimed is limited to £50 per week (the green bars), housing benefit is completely withdrawn when 20 hours of work is done. But when the housing benefit is not limited and the full £75 is claimed, housing benefit is not completely withdrawn until 27 hours of work is done.

In this example, the lower housing benefit entitlement means there is a greater incentive to go from working 20 hours to 27 hours per week (the green bars are higher than the red bars). But once 27 hours of work is done none of the scenarios claim housing benefit and the incentive to work more hours is the same.

Impact on wellbeing

We now look at the impact of the LHA changes on disposable household income (income after tax and housing costs). The figure below uses the same hypothetical household used above and the same three housing costs/LHA scenarios, but this time it shows how total weekly disposable income changes as the number of hours worked increases.

When the household is unemployed (working zero hours) earnings are nil and all income comes from the State through job-seekers allowance and, where applicable, housing benefit. This amounts to an income after housing costs of £72 per week. However, after the LHA changes, housing benefit does not cover all housing costs – there is a £25 shortfall. This shortfall has to be met through their job-seekers allowance leaving them with a disposable income of £47 per week (the green line).

Once 10 hours of work is done, housing benefit starts to be tapered away. At this point someone without housing costs has a higher disposable income than someone with, as they do not have to spend any of their earnings on housing. Those with a housing cost have to spend more of their earnings on rent as housing benefit is tapered away. As a result of the LHA change the household remains £25 worse off as their lesser housing benefit amount is also tapered away.

As seen before, once 20 hours of work are done, a household affected by the LHA change (with the lower housing benefit entitlement) ceases to be eligible for housing benefit and covers their entire housing cost without State help. At which point none of their additional earnings needs to go towards housing costs and there is a narrowing of the income gap with those with the former LHA rate who remain subject to the housing benefit taper. Once 27 hours of work is done, both cases pay their housing costs in full the green and the red lines are the same.

In summary, the impact of the lower LHA rates is to cut the disposable income of those households affected. This cut persists as they enter work and even when their entitlement ends completely. It is only when 27 hours of work is done that the loss of income from the LHA cut is fully restored.

Impact on Government spending

The figure above can also show us the impact a LHA cut has on Government spending on housing benefit. The reason that a household affected by the LHA change (green) is worse off in the graph above is because they are entitled to less housing benefit than a household with full entitlement (red). This gap between the red and green line on the graph is the cut in housing benefit resulting from the LHA cut, which is also the savings to the State in reduced housing benefit. The saving is a flat £25 until the point when those affected by the cut are no longer entitled. At this point the saving gradually falls until earnings reach the point where any household would pay its housing costs in full regardless of the LHA cut.

Summary

The lower LHA rates do increase work incentives; but it does not affect the incentive to go from zero to a small number of hours of work. It increases the incentive to work *more* hours (for example, to go from part-time to full-time work) and this only applies to a very narrow number of hours.

Lowering LHA makes those affected worse off financially; an affected household is never better off as a result of the LHA changes. A workless household would need to use their income from job-seekers allowance to cover the housing benefit shortfall. This drop in income applies even when affected households enter work and when they have earned enough to no longer be entitled to housing benefit. Income is only restored to the pre-change level when an equivalent unaffected household earns enough to no longer be entitled to housing benefit.

LHA does save the Government money. In the same way that a household is worse off as a result of a lower LHA rate, the State is better off through reduced housing benefit payments.

5. Practical impacts of LHA changes in London

Introduction

Aim

The previous chapter explored the theoretical impacts of the LHA changes on the incentive to work, household wellbeing and Government spending. But the example used was a straightforward one: a single adult, paid the National Living Wage, with low housing costs. This chapter explores how this theoretical picture differs in practice when the situations of households are more realistic in terms of pay levels, household size and most importantly, as is the case of London, housing costs are much higher.

Approach

In the same way that we looked at how the changes impacted on a simple household in the previous chapter, in this chapter we model these impacts on three hypothetical families. To produce the results we use a model developed by NPI that shows how household benefit entitlement and disposable income varies depending on a number of factors including: the number of people and the ages of household members; the amount of hours worked by the adults in the household; the hourly pay of those working; the housing cost for the household; and the housing benefit entitlement. It produces outputs representative of the tax-benefit system in place in the financial year 2013/14.

There are many different types of household living in London claiming housing benefit. In order to contain the analysis we focus on three family types. These households were chosen as they represent three common family types, each with different benefit entitlements. They are:

- A single adult aged under 25 living in shared accommodation
- A lone parent with one younger child requiring a two bedroom property
- A couple with two older children requiring a three bedroom property

One of the things we are interested in for this research is the impact of LHA on work incentives and the link with changes in hourly pay, in particular among those paid lower hourly rate who are more likely to need help with their housing costs. We look at three standard pay levels:

- The National Minimum Wage (NMW) at £6.31 per hour
- The National Living Wage (NLW) at £7.65 per hour
- The London Living Wage (LLW) at £8.80 per hour

Rent levels

The main focus of this study is how London's higher rent levels alter the impact of the lower LHA rates. But London contains 14 BRMAs with a wide-range of typical rents. To contain the analysis we identify three market rent levels typical for housing benefit claimants across London's housing markets. We also look at how the situation would be different if instead the household lived in social rented accommodation.

The market rent levels used in the following scenarios were derived from the Valuation Office Agency data on rents in the 12 months to quarter 3 of 2013 for each London borough (the most recent data available at the time of writing). We looked at the rents for shared accommodation, 2 bedroom and 3 bedroom properties to match the bedroom entitlement of the families in our scenarios.

For each property size, we looked at the rent levels in each borough and identified where natural breaks between boroughs occurred. We used these to group boroughs into three: lower, middle and higher cost boroughs. We then calculated a median and lower quartile rent for each of the three cost areas.

Finally we calculated the mid-point between the lower quartile and median rent levels to return the final rent levels to apply to the scenarios. In effect they are paying rents at around the 37.5thpercentile (half way between the lower quartile and the median). We used the same lower quartile-median gap to identify an approximate 30th percentile level to return a local LHA rate.

This 37.5 point was chosen as the rent as it reflects a household that would have previously had their housing benefit covered in full under the former system but not under the current system. It is also important to note that this is not an exorbitant housing cost; their rent levels are well in the bottom half of their local housing market. In addition many households affected by the changes could have much higher rent levels and the cut to housing benefit would be much deeper than portrayed in these scenarios.

The social rent levels used in the case studies were calculated using data from CORE. We looked at the rent levels being charged to new tenants in London in the 12 months to quarter3 2013 for each of the property sizes that the households in the scenarios would be entitled to.

Measuring the impacts

As in the previous chapter we are interested in the impacts of the reduced LHA rates on three things in particular:

- The savings to the Government – the maximum housing benefit entitlement of the family - the lower the entitlement the less the State is liable to pay.
- The incentive to work – as we showed earlier this is to do with when housing benefit payments cease and so additional earnings are no longer subject to the taper. To measure the impact on the incentive to work we will look at how many hours an individual has to work before no longer claiming housing benefit – the fewer the hours, the sooner the work incentive increases.
- The financial wellbeing of the household – this will be measured by showing the number of hours the household has to work before their disposable income (net income after housing costs) exceeds the poverty line – the lower the hours, the higher their financial wellbeing.

Single young adult

Background

The first family type we will look at is a single adult aged 23 years old. They are entitled to housing benefit towards the cost of a single room in shared accommodation. In London the typical weekly rent levels and 30th percentile LHA rates for this type of accommodation are:

Housing type	Housing cost	LHA rate
Social rent	£93	NA
Lower cost market	£94	£91
Middle cost market	£110	£105
Higher cost market	£142	£135

The weekly rent levels in London's more expensive areas at £142 are around 50% higher than its less expensive areas at £94. In terms of social rented accommodation rent levels are similar to London's lower cost private rented sector. This is because social rented accommodation does not offer shared accommodation and the rent of £93 is for a one bedroom home.

Government savings

The table shows that the State gains the most from lowering the LHA rate in London's higher cost market which saves £7 per week in benefit payment to a workless single adult (£142 less £135). But it is still liable to pay housing benefit of £135. This £7 saving from the lower LHA rate compares to a possible saving of £47 if housing costs were around £94 - the social rent level.

The incentive to work

As shown in the previous chapter, a lower LHA rate increases the incentive to work by reducing entitlement to housing benefit. This means that a household doesn't have to earn as much to no longer be entitled to housing benefit, at which point the additional income from working is greater than if they were still entitled. But our analysis found that a single young adult paid the minimum wage (£6.31) and a maximum housing benefit entitlement of £94 (the rent level in London's lower cost areas) would still be entitled to housing benefit even if they worked 35 hours per week. This is still the case even if their housing benefit entitlement was reduced to £91 per week as a result of the LHA changes.

Our analysis found that unless maximum housing benefit entitlement is **£80** or less, a single young adult paid the minimum wage and working full time would still be entitled to some housing benefit. Looking at the table above, all the rent levels and LHA rates in London exceed £80. So a single adult in London working full time at the minimum wage would still be entitled to LHA regardless of the LHA rate or price area – as a result the lower LHA rate does not incentivise work as they will always be subject to the taper.

If pay was higher such as the National Living Wage (£7.65) or the London Living Wage (£8.80) their maximum housing benefit entitlement could be no more than **£100** or **£120** to cease claiming when working full-time. Only social rent and low cost rent areas are below the threshold for the National Living Wage. At the London Living Wage London's higher cost rents exceed the threshold (this is true regardless of the LHA change).

If pay is higher, it is more likely that a single adult working full time in London would not be entitled to housing benefit. But the LHA changes make little difference to when this would happen. For example, when paid the London Living Wage in a middle rent area, a single adult would float-off housing benefit when working 33 hours without the LHA, with the lower LHA rate this is reduced to 32 hours. In short the impact on the incentive to work is negligible.

The impact on financial wellbeing

For a single adult the poverty line is £125 per week. The table below shows how the disposable income of a single young adult in each price area is affected by the reduced LHA rates. The income is given when workless and when working full time at each of the three wage levels. It also shows the number of hours required to work for incomes to rise above the poverty line.

	0 hrs	35 hrs* @NMW	@NLW	@LLW	Hrs to avoid poverty @LLW
Without LHA changes					
Social and Lower	£57	£92	£122	£150	31
Middle cost area	£57	£92	£106	£134	34
Higher cost area	£57	£92	£103	£112	>35
With reduced LHA rates					
Lower cost area	£54	£90	£122	£150	31
Middle cost area	£52	£87	£106	£134	34
Higher cost area	£50	£85	£96	£105	>35

*NMW: national minimum wage, NLW: National Living Wage, LLW: London Living Wage.

The table above shows:

- A workless young adult entitled to housing benefit for their entire rental costs has an income of £57 per week, less than half of the poverty line of £125. When LHA changes are applied they have to spend some of that £57 on housing costs and are pushed deeper into poverty.
- As discussed above, a single young adult working full-time at the minimum wage would always be entitled to housing benefit in London regardless of price area. This means that without the LHA change they have a disposable income of £92 per week (still below the poverty line). Again the application of the LHA changes further reduces their disposable income.
- A single young adult in London can only expect to have an income above the poverty line if they worked full-time and were paid the London Living Wage. However, this does not hold in London's higher cost areas.

Lone parent household

Background

The second family type we look at is a lone parent with one primary-school aged child. They are entitled to housing benefit towards the cost of a two bedroom home. In London the typical rent levels and LHA rates for this type of accommodation are:

Housing type	Housing cost	LHA rate
Social rent	£109	NA
Lower cost market	£221	£213
Middle cost market	£290	£279
Higher cost market	£398	£290*

*this is the national cap for a two bedroom property (the local LHA rate of the 30th percentile of rents would be higher at about £380).

The weekly rent levels in London's more expensive areas almost reach £400, around 80% higher than its least expensive areas at £221. However, even in the least expensive area rent is double the typical social rent cost in London (£109).

Government savings

By far, the State sees the biggest saving by applying the national LHA cap in London's higher cost areas where the maximum housing benefit cost falls by £108 to £290. This is because the national LHA cap is applied (the local 30th percentile rent is around £380). But the potential savings to the State of this national LHA cap is lower than £108 because if the LHA cap was not applied a workless lone parent would only be entitled to £345 in housing benefit and not the full £398 of their housing costs – this is because they would be affected by the overall benefit cap. So saving to the Government from applying the national LHA cap to a workless lone parent London's higher costs areas is actually £55 per week (£345 less £290).

For the middle and lower cost areas of London the local LHA rate is applied and the potential savings are lower (£11 and £8 per week respectively). However, the difference in housing cost between London's higher and lower cost areas is £177. If the variation in housing costs within London was less extreme and more affordable housing was available, the State could save much more than it does through the LHA changes.

The incentive to work

Our analysis found that unless maximum housing benefit entitlement is **£75** or less, a lone parent paid the minimum wage would still be entitled to some housing benefit even when working 35 hours a week. At the national minimum wage this level increases to **£83** and with the London Living Wage to **£90**.[2] Looking at the table above, all the rent levels and LHA rates in London exceed these maximum thresholds. So a lone parent in London working full time even at the London Living Wage would still be entitled to housing benefit, regardless of the LHA rate or price area. This means that, as with single adults, the LHA changes do not incentivise work as lone parents will always be subject to the taper.

The impact on financial wellbeing

For a lone parent with a primary school-aged child, the poverty line is £168 per week. The table below shows how the disposable income of a lone parent in each price area is affected by the LHA changes. The income is given when workless and when working full time at each of the three wage levels. It also shows the number of hours required to work for incomes to rise above the poverty line.

	0 hrs	35 hrs* @NMW	@NLW	@LLW	Hrs to avoid poverty**
Without LHA changes					
Social/lower/middle rent	£155	£242	£246	£250	3 to 2

[2] These thresholds are lower for the lone parent because the benefit system is more generous to this family type than a single adult (in particular they are entitled to child tax credits). As a result their earnings have to be higher before their housing benefit is tapered away.

Higher cost with overall cap	£102	£242	£246	£250	11 to 8
With reduced LHA rates					
Lower cost with local LHA rate	£147	£234	£238	£242	15 to 11
Middle cost with local LHA rate	£144	£231	£235	£239	16 to 11
Outer cost with national LHA cap	£47	£134	£138	£142	>35

*NMW: national minimum wage, NLW: National Living Wage, LLW: London Living Wage. ** the range of hours refers to the different pay levels: the highest value is for the national minimum wage and the lowest value the London Living Wage

The table above shows:

- The lone parent is always entitled to housing benefit, so disposable income without the LHA changes is the same for each price area, except for higher cost areas of London where the overall benefit cap is applied when the family is workless.
- The application of the overall benefit cap in London's higher cost areas cuts the income of a lone parent by £53 per week. But the effect of this cap is lifted when they are working so income at 35 hours is unaffected.
- When working full-time, increasing the hourly pay rate only increases disposable income by £4. It makes little difference to the number of hours worked to be lifted above the poverty line.
- The application of the local LHA rates makes families £8 worse-off in lower cost areas and £11 worse-off in middle cost areas. It also means that they have to work at least another 10 hours per week for income to exceed the poverty line.
- So a pay increase (from say the National Living Wage to the London Living Wage) for a lone parent working full time would not be enough to counter the loss in income from the local LHA rate (an increase of £4 per week compared to a loss of £8 or £11 per week).
- The national LHA cap leaves the lone parent in the higher cost area with a housing benefit shortfall of £108. This means a workless lone parent has a disposable income of £47 per week (compared to a poverty line of £168). Even when working full-time at the London Living Wage they are still below the poverty line with an income of £143.

This table tells us something about work incentives: the national LHA cap actually reduces the incentive to work in higher cost areas of London. For example, without the national LHA cap a workless lone parent started working full time at the minimum wage would see their income increase by £140 per week (from £102 to £242), if the national LHA cap was applied it would only increase by £87 per week (from £47 to £134). This is because without the national LHA cap the lone parent is rewarded for entering work, as the overall benefit cap is lifted. When the national LHA cap is applied there is no such reward.

Couple with two children

Background

The final family type we look at is a couple with two secondary-school aged children. They are entitled to housing benefit towards the cost of a three bedroom home. In London the typical rent levels and LHA rates for this type of accommodation are:

Housing type	Housing cost	LHA rate

Social rent	£127	NA
Lower cost market	£247	£240
Middle cost market	£320	£308
Higher cost market	£449	£340*

*this is not the local LHA rate of the 30th percentile of rents (which would be about £430) but the national LHA cap for a two bedroom property.

The weekly rent levels in London's more expensive areas reach £450, as with two bedroom properties, this is around 80% higher than its least expensive areas at £247. However, again even the least expensive rent area is almost double the typical social rent cost in London (£127).

Government savings

The State savings for this household are not simply the gap between rent and the LHA rate. As with the lone parent household in London's higher cost areas, the overall benefit cap takes affect this leaves a workless couple with two children a maximum of £238 to spend on rent. This cap is lower than the national LHA cap and local LHA rates. As a result the LHA changes do not save the Government any money in terms of the amount of benefit paid to workless couples. It is only when the couple enter work (and qualify for working tax credits) that the LHA changes take effect and the savings are realised.

So the State saving from the LHA changes only comes from working couples. The saving is greatest again under the national cap where the LHA paid is £159 less than rent, where the local rates are applied the cut is much less at £12 and £7.

The incentive to work

Our analysis found that unless maximum housing benefit entitlement is **£124** or less, a couple paid the minimum wage would still be entitled to some housing benefit even if both adults work 35 hours a week. At the National Living Wage it would be **£141** and at the London Living Wage it would be **£155**.

Looking at the table above all the market rent levels and LHA rates in London exceed the level required to float off housing benefit. It is only living in social rented housing at a cost of £127 where the couple working full-time could earn enough to not be entitled to housing benefit.

But in market rent accommodation, before and after the LHA changes, a couple working full time for the London Living Wage would still be entitled to housing benefit – as with the single adult and the lone parent family, the LHA changes have no practical impact on work incentives.

The impact on financial wellbeing

For a couple with two children the poverty line is £348 per week. The table below shows how the disposable income of a couple in each price area is affected by the LHA changes. The income is given when workless and when both adults are working full time (35 hours each) at each of the three wage levels. It also shows the number of hours required to work for incomes to rise above the poverty line.

	0 hrs	70hrs*			Hrs to avoid

		@NMW	@NLW	@LLW	poverty**
Without LHA-changes					
Social rent	£220	£370	£395	£417	60 to 48
Lower cost area with overall cap	£220	£356	£365	£373	60 to 48
Middle cost area with overall cap	£180	£356	£365	£373	60 to 48
Higher cost area with overall cap	£51	£356	£365	£373	60 to 48
With reduced LHA rates					
Lower cost area with local LHA rate	£213	£349	£358	£366	68 - 52
Middle cost area with local LHA rate	£180	£344	£353	£361	>70 to 56
Higher cost area with national LHA cap	£51	£247	£256	£264	>70

*NMW: national minimum wage, NLW: National Living Wage, LLW: London Living Wage. ** the range of hours refers to the different pay levels, the highest value is for the national minimum wage and the lowest value the London Living Wage

The table above shows:

- The couple is always entitled to housing benefit at the market rents, so disposable income without the LHA change is the same for each price area, except if the family is workless then the overall benefit cap is applied.
- The overall benefit cap cuts the income of a couple by £8 in lower, £81 in middle and £210 in higher cost areas of London – this cap actually overrides the LHA changes. So the LHA changes do not impact on the financial wellbeing of a workless couple in London. The overall benefit cap leaves them with an income considerably below the poverty line.
- When working full-time, increasing the hourly pay rate only increases disposable income by £10 per week.
- The application of the local LHA rates makes families working full-time £9 worse-off in Outer London and £12 worse-off in mid-London.
- The national LHA cap leaves the couple in London's higher cost areas with a housing benefit shortfall of £110. This means a couple working full time at the living wage has a disposable income of £280 per week (compared to a poverty line of £348).

As with the lone parents this table shows that when the LHA changes interact with the overall benefit cap they actually reduce the incentive to work in London's higher cost areas. When the overall benefit cap is lifted as workless couples enter work, the additional benefit income (the incentive to work) is much less as a result of the reduced LHA rates.

Summary

Impact on Government spending

Both the reduced LHA rates and the national LHA caps save the Government money by reducing the maximum amount it has to pay in housing benefit. These cuts are greatest in larger properties and for those in higher cost areas. Per person affected, the cuts from the national LHA cap save the Government the most.

But this saving through the national LHA cap is no longer as high as it was when introduced in 2011. This is because the overall benefit cap has since been implemented (fully rolled out in September 2013) which often overrides the national LHA cap. It is not clear if assessments of the savings in 2013 and beyond account for the fact that in the absence of the national LHA cap, much of the saving would still be made.

Because London rents are so high, even LHA rates at the 30th percentile save little compared with what would be saved if there were greater access to affordable housing. For example, for a two bedroom property in London's lower cost area, the lower LHA rate reduces the State's liability to pay housing benefit by £8 to a maximum of £213 per week. In affordable housing, the liability could be reduced to £109 per week, saving an extra £104.

Impact on the incentive to work

The lower the level of housing benefit, the lower the level of income at which a household floats off the benefit. At this point, the incentive to work, as measured by the share of any additional gross earnings retained, goes up. As this only happens when earnings are high enough, reducing LHA rates does not change the incentive to enter work– only the incentive to do more work at this level and above.

However, as London rents are so high even when LHA is limited to the 30th percentile, neither lone nor couple parents working full-time at the London Living Wage actually escape housing benefit. So the benefit in principle of a higher incentive to work is never realised in practice, at least at anything like reasonable or plausible weekly hours of work.

In London, the LHA changes can also undermine the incentive to enter work created by the overall household benefit cap. London's high rents mean that workless lone and couple parents are often affected by this overall cap. As it only applies to workless households, its removal should create a strong incentive to enter work – except that in London, as soon as the overall cap comes off, a working family is immediately caught instead by the reduced LHA rate, meaning that the additional income from entering work is much less.

Impact on wellbeing

London's high housing costs mean that cuts to income from the LHA changes are greater, particularly in the higher cost areas where the national LHA cap is applied. The national LHA cap results in a potential fall in income of around £108 per week. A workless lone parent facing a housing benefit shortfall of £108 has just £47 per week to cover all other costs for their family (food, clothes, fuel etc).

London's high rents also mean that many households are unable to work enough ever to neutralise the cut, something which only happens at the earnings level when housing benefit would have been zero even without the LHA changes. For those on the London Living Wage, this doesn't happen even when working full-time. So this is not just a cut in income to those who do no or little work: in London at least, it is a cut for all low paid however much they work. The national LHA cap can even push those working full-time below the poverty line.

The analysis here shows that social rented accommodation is the optimum scenario on all measures. In social rented accommodation:

- the work incentive is greatest – housing costs and therefore housing benefit entitlement is lowest so a household does not have to earn as much to no longer be entitled to a benefit

- the cost to the State is the lowest – even when housing benefit is provided for the full cost of rent this is still much less than the cost of housing benefit for only a share of rent in the open market
- the disposable income of working households is highest – quite simply when housing costs are less the household has a greater disposable income

6. Up-rating LHA rates

Background

Along with lowering LHA to the 30th percentile of local rents and the introduction of the national LHA cap, this Government has also changed the way LHA is up-rated.

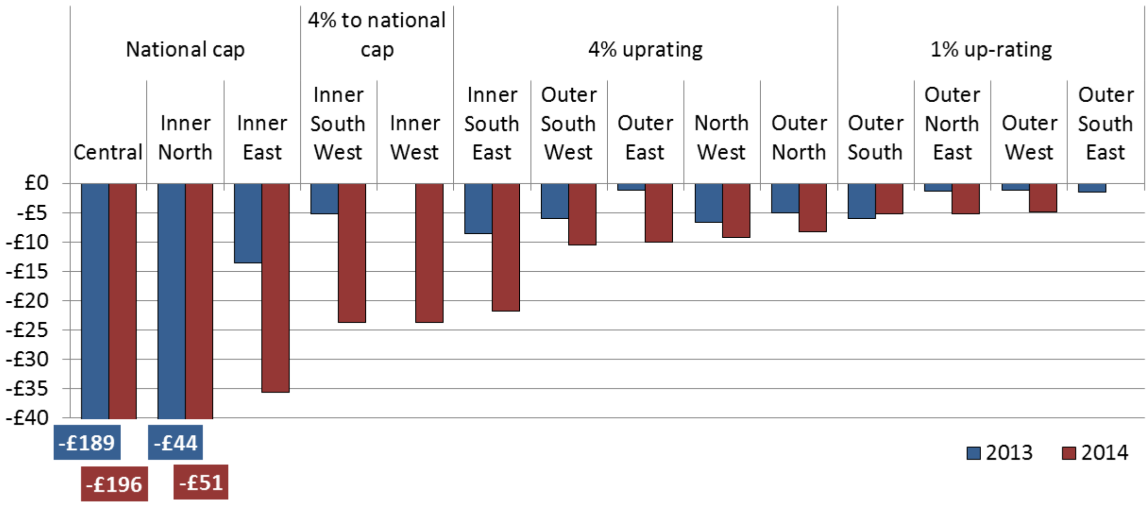
LHA, as with all benefit levels, needs to be adjusted over time as costs change. Job-seeker's allowance was traditionally up-rated annually by an index of inflation as it provides workless individuals with an income to spend on meeting their basic needs. Housing benefit on the other hand is a benefit intended to cover the cost of a specific item: rent. So LHA was up-rated monthly in-line with changes in local rent levels. This created a direct link between the value of the benefit and the cost that benefit is intended to cover.

Starting in April 2012 LHA levels were frozen and the system changed to one of annual up-rating rather than monthly. The first annual up-rating took place in April 2013 and rather than moving to the new 30th percentile level of local rents, they were up-rated by that or CPI (at 2.2%), whichever was lower. When announced it was assumed that the system of annual up-rating would continue in this way.

But it has since been confirmed that in April 2014 and 2015, LHA levels will be up-rated to the lower of the 30th percentile level of local rents or by 1%. However, in some of the most strained markets LHA will be increased by 4%. For April 2014 106 out of 760 local LHA rates have been identified for an up-rating of 4%. Half of the LHA levels in operation across London qualified for a 4% up-rating. The national LHA caps will be up-rated by 1%.

The gap between local LHA and local rents

As the LHA levels for each BRMA in April 2014 have been confirmed we can see how they differ from the 30th percentile level in the two years since the up-rating mechanism changed (2013 and 2014). The graph below focuses on the LHA levels for two bedroom properties in London's 14 BRMAs. It shows the gap for each year between the 30th percentile of local rents and the LHA rate applied in the area.



It shows that in 2014 the gap is widest in the 3 BRMAs affected by the national LHA cap. At its most extreme, the maximum LHA that can be claimed in Central London is almost £200 per week less than the 30th percentile of rents. The next largest gaps are in the BRMAs that qualified for the 4% up-rating. Those areas with the smallest shortfall are those with only a 1% up-rating in 2014.

The Inner South West and Inner West BRMAs were areas eligible for the 4% up-rating in April 2014, but in applying this 4% increase they reach the national LHA cap. For two bedroom properties, when the national LHA caps were introduced in April 2011 it was only in 2 BRMAs where the 30th percentile of local rents exceeded the national LHA cap. In 2014 this will be the case for 5 BRMAs, all of them in Inner London.

In all but the Outer South East BRMA the LHA rate in 2014 for two bedroom properties will be at least £5 less than the 30th percentile rent level. In all but two BRMAs in London (the Outer South East and Outer South) the gap between the 30th percentile and LHA will be bigger in 2014 than it was in 2013.

What are the impacts of this LHA up-rating?

On household income

The previous chapter explored the impact of a shortfall between housing costs and LHA entitlement. It focused on the introduction of the lower LHA entitlement for a household with a rent above the 30th percentile. The same principle applies here, but this time the cut that they initially faced when the changes were introduced could increase year-on-year if their rental cost increases in line with the market rather than the LHA rates. The impact is the same as we saw in the previous chapter, but the gap between housing costs and housing benefit entitlement is slightly bigger and so disposable income is slightly lower.

In almost all of London's BRMAs the gap between LHA and the 30th percentile of local rents is increasing. So in addition to households already above the 30th percentile experiencing a further drop in their disposable income, households within the 30th percentile of rents may find their rent increases in-line with the market but their LHA level has not. As a result a typical rent increase could push some households over the LHA rate and reduce their disposable income.

On State spending

In terms of the impact on Government spending, a saving is made as the State is liable to pay a lower amount in housing benefit in future years than if LHA was pegged to 30th percentile. But this saving only applies to increases in rent above the LHA rate. If rent is below the LHA rate and increases within it, the State is still liable to provide housing benefit in full. The State only saves when rent increases for those households already at or above the LHA rate, as these households and not the State are fully liable to cover the cost of any rent increase above the LHA up-rating.

On work-incentives

The supposed increase in work incentives created by lowering LHA to the 30th percentile occurs because it reduces the number of hours a household has to work before they are no longer entitled to benefit and therefore their additional earnings are no longer subject to a benefit taper. But limiting LHA increases doesn't actually reduce the amount of housing benefit received; it merely means that the gap between rent and LHA could increase. As

LHA still does increase (but only by a fixed amount rather than by rent) the entitled households still have to work the same number of hours to no longer be entitled to housing benefit, regardless of the rental increase.

On housing choice

As explained above, in all but one of London's BRMAs the LHA levels are lower than the 30th percentile of rents. So in these areas, less than 30% of rental properties charge rents within LHA. So the ability of households facing a benefit shortfall to move to accommodation within the LHA limit is further constrained. (This report has already shown that even at the 30 percentile need outstripped supply.)

One of the merits of up-rating LHA in line with inflation rather than local rents is that it incentivises claimants to negotiate any rent increases with their landlord. But when the housing market in London is under the pressure that it is, it is unclear how much influence a single tenant can exert, given the wider market and demand. Likewise, the Government has much less incentive to rein in rising private rent market generally, despite it being the only player with the means to exert influence on the market as a whole.

7. The theoretical impact of UC

Aim

In this chapter, we consider how the introduction of Universal Credit (UC) alters the impacts of the LHA changes described so far in this report. Before looking in the next chapter at more complicated (and realistic) examples of how UC affects households, in this chapter we explore the theoretical impacts of UC on a simple household.

Methodology

The example household is a single adult aged 35 paid an hourly rate of £8.80 (the London Living Wage) with a housing cost of £75. If out-of-work, they are assumed to be entitled to jobseeker's allowance (JSA). We explore the impact of UC by looking at how income after housing costs varies as they enter work under a range of benefit scenarios:

Firstly we explore how UC affects the household before factoring in the changes to LHA. So we compare two benefit scenarios:

- They claim UC and have no LHA limit (red solid line in the following graphs)
- They claim JSA and have no LHA limit (red dotted line)

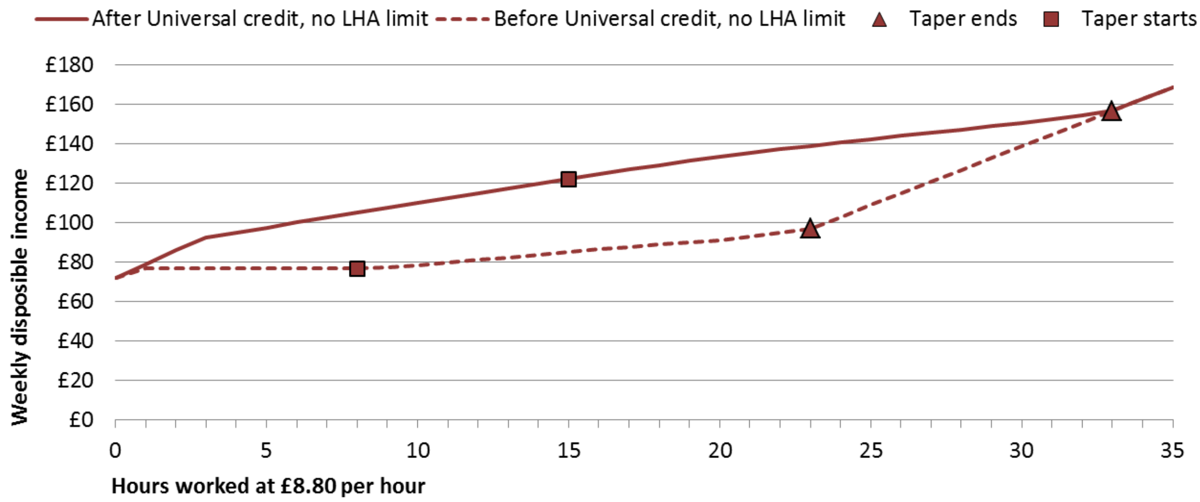
We then look at how the LHA changes alter the impacts of UC by adding another two scenarios:

- They claim UC and have a reduced LHA rate of £50 (blue solid line)
- They claim JSA and have a reduced LHA rate of £50 (blue dotted line)

The switch from the current system to UC

UC combines three means-tested out-of-work-benefits (jobseeker's allowance, income support and employment and support allowance), two tax credits (child and working) and housing benefit into a single benefit withdrawn at a single rate. In so doing, it removes inconsistent incentives to work more hours which can arise when multiple benefits (such as when tax credits and housing benefit) are withdrawn simultaneously.

The graph below shows how the disposable income of the household described above (single adult aged 35 with a housing cost of £75) changes when the hours worked at £8.80 per hour increase from 0 to 35. The dotted line shows disposable income when Job Seeker's Allowance (JSA) and housing benefit is claimed and the solid line shows disposable income when UC is claimed.



The graph shows that the switch to UC from the current system achieves two things:

1. UC's single taper makes the income line much smoother. The slope of the line is an indication of the incentive to work: the steeper the slope, the greater the incentive. Under the current system the line is jagged. The incentive to move from 5 to 6 hours is nil, from 15 to 16 hours is small and from 26 to 27 hours is slightly bigger. Overall the incentive to work under UC is much more consistent.

2. Those working a small number of hours are clearly better off under UC (the line is higher). When someone enters work the first benefit that is tapered away is JSA. Under the current system, this benefit is tapered away pound for pound as earnings rise (after an initial £5 disregard, the dotted line starts off flat) so the individual only really starts to be better off from working once they are doing more than 8 hours per week. Under UC, the tapering is gradual from the start. As a result, UC makes 'mini-jobs' with just a few hours of work more financially rewarding. This impact is to do with the way that JSA is withdrawn rather than housing benefit.

But these changes have wider consequences. It is not just those doing mini-jobs who are better off under UC. Financial wellbeing is always greater when any UC is being received (the solid line is always higher than the dotted line until they meet when UC is fully withdrawn). This would not be true for a household subject to the overall household benefit cap, which we explore in the following chapter.

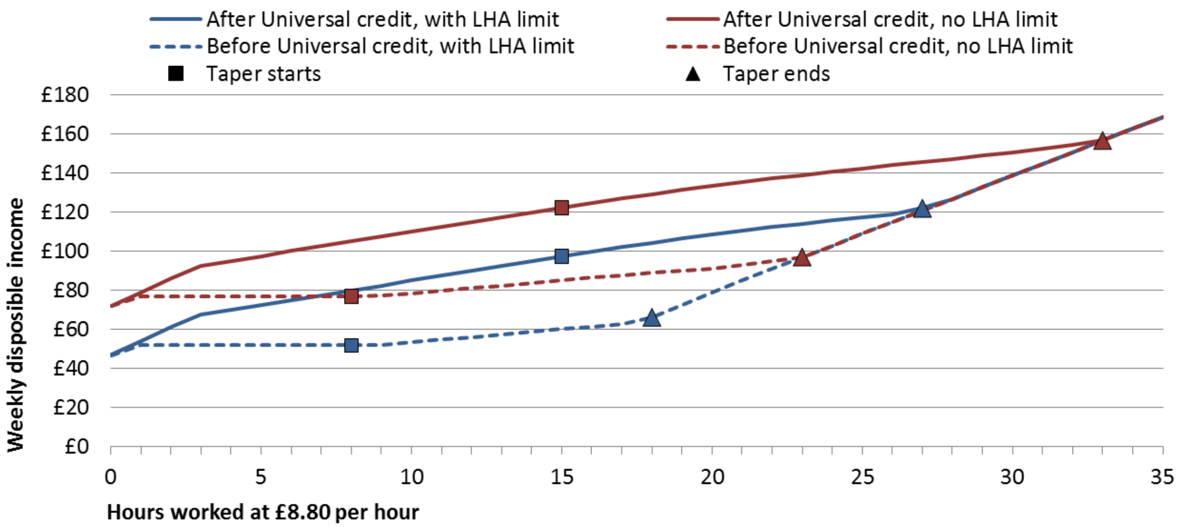
Because UC is more generous to start with and has a lower taper than JSA, UC claimants are entitled to some form of benefit for longer. The triangles on the graph indicate when the UC or housing benefit claim ends. In this case, a claim for housing benefit ends when 23 hours of work is done but a claim for UC ends when 33 hours of work is done.

The direct result of all this is that the introduction of UC costs the Government money compared with the present system.

The effect on work incentives is mixed. Compared with the present system, the incentive under UC is greater – but only until the points where the current system ceases to provide any benefit (the triangle on the dotted line). Above this level – and until UC itself has tapered to zero (the triangle on the solid line), the UC line is less steep – and so the incentive to work is weaker.

The interaction of the LHA changes and UC

How does the change to LHA alter this picture? The graph below replicates the one above but includes an additional two lines where an LHA rate of £50 is applied to a housing cost of £75 (one under UC and one under JSA). The square markers on the graph show where housing benefit in the current system and the 'housing component' of UC begins to be tapered away. The triangle markers show when the benefit claim ends altogether.[3] In this simple example, entitlement in the housing component of benefit ends last and is the equivalent to all benefits ending.



Firstly, we will consider work incentives. The graph shows that under the current system the lower LHA rate changes the work incentive between 17 and 23 hours (where the two dotted lines are not parallel). The housing benefit claimed by the household with reduced LHA stops at 17 hours (marked by the triangle on the blue dotted line) at which point income increases at a faster rate until 23 hours where the household without the reduced LHA also stops claiming housing benefit (marked by the triangle on the red dotted line).

As Universal Credit has a more generous taper than job seekers allowance, the housing benefit component of UC does not begin to be tapered away until 16 hours of work is done, compared to 8 hours under the current system. This means that UC shifts the impact of the LHA change on work incentives to between 27 and 33 hours (rather than 17 and 23 hours before UC). In short, UC delays the increased incentive to work from the LHA change until hours/earnings are higher.

In terms of the impact on disposable income, the LHA changes have broadly the same effect under UC as the current system: they reduce a household's disposable income (the blue solid line is below the red solid line). This income cut is the shortfall between housing costs and the LHA rate. It is only when the household has reached an income level where they would no longer be entitled to housing benefit for all of their housing costs (regardless of the

[3] As there is no identifiable housing benefit within UC, we calculate the 'housing component' of UC by comparing additional UC income a household with a particular housing cost gets compared to an identical household with no housing cost.

LHA rate applied) that this income cut is neutralised. In the graph above, the income cut is neutralised at 33 hours under UC and 23 hours under the current system. So under UC hours/earnings have to be higher for this income cut to be neutralised than under the current system.

But how much does the overall improvement in income delivered by UC counter the cut in income delivered by the LHA change? This can be seen by comparing the current system before the LHA change (the red dotted line) with UC plus the LHA change (the blue solid line).

At zero hours, UC with the LHA change provides less money than the current system without the LHA change – at this stage the income difference is simply the gap between the LHA rate and housing costs (£25). But as the household enters work under the current system JSA is withdrawn pound-for-pound, whereas UC tapers it away gradually. This means that the additional income from the more generous taper counters the income lost from the LHA cut once 6 hours of work is done. From that point onwards the household on UC with the LHA change applied is better off.

Summary

In short the introduction of UC has six effects. They are:

1. UC provides a consistent incentive to work
2. UC makes mini-jobs more worthwhile
3. UC is more generous than the current system (though the overall benefit cap overrides this)
4. UC lasts longer (that is, goes on being paid at higher hours and earnings)
5. UC costs the Government money
6. UC has a higher work incentive at lower earnings but can be a lower one at higher earnings

But the application of the LHA changes within UC has three further effects. They are:

7. UC delays the point when the higher work incentive with the LHA change kicks in
8. UC delays the point where the income cut from the LHA change is neutralised
9. But the introduction of UC has the potential to counter the income cut created by the LHA changes for all those doing at least a small amount of work

8. Practical impacts of universal credit

Aim

In the previous chapter we looked at the theoretical impacts of UC on household income and how this altered the impact the LHA changes. Earlier in this report we focused on the impact of the LHA changes on particular households across London's house price areas in terms of:

- Government spending
- Work incentive
- Disposable housing income

In this chapter we look at how UC will alter the impact of the LHA changes in London described in Chapter 5. We focus primarily of the last of these as the impact on the first two is minimal.

Impact on Government spending

As already shown in this report, the reduced LHA rates saves the Government money by cutting the amount it has to spend on housing benefit, whilst UC costs the Government money. In practice this is not affected by London's higher housing cost.

Impact on work incentives

Chapter 5 showed that the LHA changes do not alter the work incentives when applied in London due to the capital's high housing costs. These costs mean that even when housing benefit is limited to the 30th percentile of local rents, low paid households would still be entitled to housing benefit when all adults in that household are working full-time. The previous chapter showed that one of the impacts of UC was to further increase the hours a household had to work to no longer be entitled to housing benefit. So in practice UC makes the claimed work incentives from the local LHA rate even less likely to apply in London.

However, UC does increase the incentive to work in its own right by creating an incentive to enter work and take jobs with only a small number of hours. Under the current system of job-seekers allowance that incentive is remote. But this increased incentive created by UC applies regardless of the LHA rate and London's high housing costs.

Impact on wellbeing

The previous chapter showed that the main gain in household income from UC was linked with this increased incentive to enter work. Households in work are better off under UC because their earned income is tapered as soon as they enter work rather than withdrawn pound-for-pound under JSA. So a workless family under UC has the same income as a workless family before UC, but a household doing a small number of hours under UC is better off than one under the current system. The previous chapter also showed that this additional income from UC could potentially counter the income cut from the LHA changes for those who are doing a small number of hours.

But to what extent does this increased income from UC counter the income cuts from LHA for households in London? To answer this question we return to the three household types we looked at in Chapter 5. As explained above, the consistent UC taper has the biggest impact when a household first enters work, when benefit is withdrawn at 65% compared to 100% for JSA. The table below shows the additional income that each of the three households from chapter 5 would have under UC at the point when JSA income is fully withdrawn. It assumes that under UC and JSA they are unaffected by the LHA changes.

	Single young adult	Lone parent, 1 child	Couple, 2 kids
Additional income under 65% UC taper compared to 100% taper on JSA	£40	£55	£65
Hours of work required to reach this level	8	10	14

So what does this table mean? For each household type it shows us the additional income that UC delivers when the household first enters work. So if the household's income cut through LHA is less than the amount gained, UC could counter this loss of income. For example, if the LHA cut to a single young adult is greater than £40, the additional income from Universal Credit is unlikely to be able to offset the income lost through the LHA change. If the LHA cut is less than £40, the additional income from UC will be greater than the LHA cut, once 8 hours of work is done. For a workless single adult though, their income is cut through LHA and unchanged by UC. So UC is only able to counter the loss of income from an LHA cut if:

a. The cut in LHA is less than the amount in the top row of the table *and*
b. The household does the number of hours worked in bottom row of the table

The table below presents data from the DWPs impact assessment[4] in advance of the introduction of the 30th percentile LHA rates. It shows the estimated cut in LHA to claimants in London due to 30th percentile rate in 2011/12.

Estimated cut LHA to claimants	£0	£0-£10	£10-£20	£20-£30	£30-£40	£40+
Share of all LHA claimants in London	29%	27%	24%	11%	7%	3%

The estimates show that the vast majority of LHA claimants in London saw their incomes cut by less than £40 in 2011/12. So for those households in work, the additional income from UC could be enough to counter the impact of the LHA changes. However, there are three major caveats here. The first is that the table above reflects the cut to LHA in the first year of implementation. The analysis in chapter 6 has shown that LHA rates have not kept pace with the 30th percentile in London and the overall LHA cut by the time UC is implemented will be much greater. The second is that, the national LHA caps are much more severe, with cuts in excess of £100 per week that UC will never counter. The last is that UC only makes a household better off when it is in work. For workless households they are no better off from UC regardless of the cut income from LHA.

Summary

In short, UC has two impacts on the LHA changes in London. Firstly, UC increases the incentive to *enter* work, and this is no different in London where housing costs are higher.

[4] See table 17, http://www.dwp.gov.uk/docs/impacts-of-hb-proposals.pdf

But it also means the LHA changes which alter the incentive to do *more* work are even less likely to have an impact in London. (However, this impact was largely negligible in London before UC anyway).

Secondly, when LHA is cut by a small amount *and* the household does a small amount of work, UC's greater generosity (arising from its lower taper than JSA) can more than offset the adverse effect of the LHA changes on disposable income. But where those conditions are not met, UC's beneficial effect is not enough to counter the income cut by LHA. Given London's higher housing costs, the size of the cut through the national LHA cap and the growing gap between the actual 30th percentile and the LHA rates across London, it is less likely that UC will counter the loss of income experienced by many families in London from the LHA cut, regardless of how much work they do.

9. Findings and policy implications

Aim

The aim of this study was to explore how far the lower LHA rates and national LHA cap introduced in April 2011 are able to achieve their aims in London where housing costs are much higher. The Government's primary aims of the LHA changes were to (a) cut/contain spending on housing benefit and (b) increase the incentive to work. In this study we considered how far these aims can be realised in London's housing market and also how this impacts on disposable household income. We also explored how this would alter over time as changes to the way that LHA levels were uprated take effect and as Universal Credit (UC) is introduced.

In this final section we bring together the key findings of the analysis and reflect on what that indicates for policy.

The impact on disposable income

Chapter 4 showed that lowering LHA rates makes affected households worse-off financially. A household with a rent level above the reduced LHA rate will have their housing benefit entitlement cut, and their housing benefit income cut in turn. This absolute cut in housing benefit entitlement applies to all households – not just workless households. As a result, affected households continue to be financially worse off even as their earnings increase. It is only when earnings reach the point at which they would not have been entitled to any housing benefit before the LHA rate was lowered that the household is no longer worse-off. Households are never financially better-off as a result of a reduced LHA rate.

However, as chapter 5 showed, London's high rents mean that many households cannot earn enough to reach this point. Even lone parents and couples with children working full-time at the London Living Wage would still be affected by an LHA cut. The lower LHA rates do not just cut the income of those doing little or no paid work but also most low earning households in London's private rented sector. The income cut from the national LHA cap tends to be much greater and can even leave those working full-time below the poverty line.

Another option for households affected by the reduced LHA rate would be to move to accommodation that charges a lower rent that was at or below the LHA rate. This would have the effect of restoring disposable income to the level it was at before the LHA cut (although the quality of their accommodation is likely to be lower). However, chapter 3 showed that it is not feasible for all households to find accommodation within the 30th percentile cap. For example, across London more than 30% of private renters entitled to two bedrooms claim LHA. In addition chapter 6 showed that the changes to the way that LHA levels are up-rated means that less than 30% of properties now fall within the LHA rates.

Chapters 7 and 8 showed that UC has the effect of raising the disposable income of households doing some work. For single young adults, lone parents with one child and a couple with two children, the increase can be around £40, £55 and £65 a week respectively. So if the cut to LHA is relatively small the introduction of UC could more than compensate for the loss of income (this only applies to households where someone is in work).

However, in London cuts to LHA are greater, in particular when the national LHA cap is applied. As a result of the lower uprating of the LHA rates, the 'reach' of the national cap is spreading. For two bedroom properties, the number of broad rental market areas in London where the national LHA cap applies has increased from two out of 14 in 2011 to five in 2014 (chapter 6). So for many households in London, UC is unlikely to counter the impact of the LHA cut, regardless of how much work is done.

Work incentives

Chapter 4 explored how a lower LHA rate can change the incentive to work. It showed that whilst it does nothing to improve the incentive to enter work, it does improve the incentive to increase the amount of work already done. This is because a lower LHA rate means a household ceases to be entitled to housing benefit when their earnings are at a lower level than before. This increased incentive to work is a result of no longer having housing benefit income withdrawn as earned income increases.

But as rents in London are so high, even when LHA is limited to the 30th percentile, even lone and couple parents working full-time at the London Living Wage remain entitled to housing benefit (as shown in chapter 5). So the improved incentive to increase the amount of work already is unlikely to be realised in practice in London.

The analysis also showed how in London the national LHA cap and the overall benefit cap interact. The overall benefit cap is designed to increase the incentive to work as it only applies to workless households. But when the national LHA cap is in place the rewards of the overall benefit cap being lifted are much reduced. As a result the national LHA cap actually reduces the incentive to work.

In itself, UC creates a significant incentive to enter paid work, notably into mini-jobs of just a few hours a week. This improvement is not the result of any particular change linked to housing benefit but rather introducing an income taper which does not exist for job-seekers-allowance.

Because of UC’s consistent taper, households are entitled to some benefit towards their housing costs at higher earnings levels than under the current system. This means the increased work incentives resulting from the lower LHA rates are even less likely to have an impact in London.

Government savings

Both the lower LHA rates and the national LHA cap save the Government money. The cut in housing benefit and therefore savings to the Government are greatest for larger properties and those in higher cost areas, particularly those where the national LHA cap is applied. However, the savings from the national LHA cap is less in 2013 than when it was when it was introduced in 2011 because the overall benefit cap now achieves many of those saving.

The change to the way that LHA levels are up-rated also saves the Government money, as the amount it is liable to spend on housing benefit increases by less than it would under the former up-rating system. However, it means that the Government has no reason to bear down directly on rental levels. If rents rise, the Government is sheltered from paying higher housing benefit, leaving tenants as the sole agents of change and bearing the full consequences.

Implications for policy

Using the benefit system to control housing costs has reached its limit

The LHA changes and overall household benefit cap have cut central Government's liability to pay housing benefit. But the damage in living standards is clear and the improvements in incentives do not in practice materialise. In addition, the improved living standards from UC are likely to be overwhelmed in London as a result of the LHA changes. We conclude that the use of the benefit system to control housing costs has reached its limit.

Social rented sector is the optimum rented tenure for tenants and Government alike

The alternative is the expansion of the social rented sector. Social rented accommodation is the optimum scenario on all three of our criteria: the work incentive is greatest, the cost to the State is lowest and the disposable income of working households is highest.

The national LHA cap, overall benefit cap and LHA uprating should be reconsidered

In the meantime, we recommend the abolition of the national LHA cap on the grounds that the overall benefit cap is now able to limit excessively high housing benefit payments. In addition the national LHA cap interferes with the incentive to enter work provided by the overall benefit cap.

The impact of the overall benefit cap on household disposable incomes can be particularly severe for families with children in London. This is partly because the cap does not account for household size. At present, a workless couple with two children is entitled to less housing benefit than a workless couple with none. Given that the former clearly requires more housing than the latter, the overall benefit cap should be adjusted to account for household size.

Lastly the process by which LHA is uprated should be revisited. Under the former system the State met the cost of rent increases for claimants. Under the current system, cost increases fall almost entirely on the tenant. This is not sustainable in the long-term. An alternative that might be sustainable would be one in which both the State and the claimant have an incentive to contain increases in rents.