findings

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Reforming Housing Benefit for private tenants and tax credit recipients

The Government is considering radical reform of Housing Benefit for private tenants. Meanwhile, the new system of tax credits planned for 2003 provides the opportunity to improve the relationship between tax credits and Housing Benefit. Work by Professors Peter Kemp and Steve Wilcox has explored options for reforms to restructure and simplify the current Housing Benefit scheme.

- **Seven out of ten private tenants subject to the post-1996 system of rent restrictions have some of their rent ignored when their Housing Benefit is calculated. On average, the rent used to calculate Housing Benefit is £19 per week below the rent charged by the landlord. These shortfalls can cause hardship for claimants, especially in London and for young people subject to the 'single room rent' restriction.**

- **The pre-1996 rent restrictions are no less important than the local reference rent and single room rent restrictions introduced in 1996. Thirty-nine per cent of the rents eligible for Housing Benefit were reduced under the pre-1996 restrictions, 37 per cent under both sets of restrictions, and just 24 per cent solely under the restrictions introduced in 1996.**

- **A simpler, 'shopping incentive' system could significantly reduce the shortfalls that result from the rent restrictions. It would also be more transparent and easier to administer.**

- **Entitlement to the new pension credit will not result in an offsetting reduction in Housing Benefit entitlement. The means-testing of modest savings will be significantly eased. The treatment of earned incomes has yet to be resolved, but remains critical if overlaps between the pension credit and Housing Benefit are to be entirely avoided.**

- **There are no equivalent proposals to rationalise the relationship between Housing Benefit and the new child and working tax credits. The researchers outline two approaches that would provide a more coherent relationship between the tax credits and Housing Benefit. Both would minimise the overlap between these schemes and reduce the number of households subject to a severe poverty trap.**

- **Half the poorest households in the UK are home-owners. Including low-income home-owner households in a restructured tax credit and Housing Benefit scheme would remove the unemployment trap that can leave them worse off in work.**

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Background

It is widely accepted that Housing Benefit needs major reform. It is poorly structured in relation to the Government's social security and housing policy objectives. It is also highly complex, poorly administered and confusing to claimants. In 2000/01, over a third of applications were not processed on time.

The Housing Policy Green Paper, published in 2000, acknowledged that Housing Benefit has serious deficiencies. Since then, a number of modest but important modifications have been introduced or are planned. However, the Government included a commitment to more radical reform of Housing Benefit for private tenants in its 2001 election manifesto. Meanwhile, proposals for a second generation of tax credits to be introduced in 2003 have renewed concerns about their relationship with Housing Benefit for people in low paid employment.

In this context, the study explored options for reforms to restructure and simplify the current Housing Benefit scheme. It focused upon two key issues:

- the rules which restrict the amount of rent that is taken into account when assessing Housing Benefit entitlement (referred to as 'rent restrictions') and how they might be reformed; and
- the relationship between Housing Benefit and the new generation of tax credits.

Housing Benefit rent restrictions

When *private* tenants apply for Housing Benefit, part of their rent may be ignored if it is deemed to be too high. On deregulated tenancies, the local authority refers the claimant's rent to the rent officer, who decides what amount of rent should be used to calculate Housing Benefit in that particular case.

Prior to 1996, the rent could be restricted if it were above the market level for that dwelling, if the accommodation were too large, or if the dwelling were exceptionally expensive. In 1996, two *additional* rent restrictions were introduced: the local reference rent (LRR) and the single room rent (SRR). The LRR is the average market rent for dwellings of a particular size in the locality, and acts as a ceiling on the amount of rent that is taken into account for Housing Benefit purposes. The SRR is similar to the LRR but relates to shared accommodation and applies only to single people under 25 years.

These rent restrictions apply to different households depending on their age, the date their tenancy began, and when they first claimed Housing Benefit on the accommodation in question. It is only once tenants' applications have been processed that they find out whether, and if so by how much, their rent has been restricted for Housing Benefit purposes.

Impact of the rent restrictions

The study analysed all cases referred to the rent officer by local authority Housing Benefit officials in England and Wales in 1999 (see Table 1). It was found that, under the rules now in place, 70 per cent of cases referred to the rent officer were subject to at least one form of restriction to the rent that is taken into account in calculating Housing Benefit entitlement. The average restriction was £19 per week. It was especially large in London and on cases subject to the single room rent.

Although critics have focused on the local reference rent and the single room rent, the pre-1996 restrictions remain important. It was found that 39 per cent of the rents eligible for Housing Benefit were reduced under the pre-1996 restrictions, and a further 37 per cent under both sets of restrictions.

Only 24 per cent were reduced solely under the 1996 restrictions (i.e., the LRR and SRR).

Because of these restrictions, most new claimants with deregulated tenancies face a shortfall between their contractual rent and the amount used to

Table 1: Restrictions in rents referred to the rent officer under the post 1996 rules*

	Number of referrals	*% of referrals*	*% of restrictions*
No restriction	180,606	30	
Restriction under:			
– pre-1996 restrictions only	161,165	27	39
– 1996 restrictions only	98,412	17	24
– both pre-1996 and 1996 restrictions	154,233	26	37
Total	594,416	100	100

* England and Wales, 1999

calculate their Housing Benefit. As a result, tenants may experience financial hardship or end up with rent arrears and face possible eviction. This makes Housing Benefit recipients a more risky client group for private landlords letting accommodation.

Since the 1996 rent restrictions were introduced, the number of private tenants receiving Housing Benefit has fallen. Over the same period, there has also been a fall in unemployment, the introduction of the Working Families Tax Credit, and renewed efforts to reduce Housing Benefit fraud. The numbers of young single people in deregulated private tenancies dropped particularly sharply, from 114,000 in November 1996 to just 31,000 in May 2000. This tends to support claims that the single room rent has contributed to the reduced supply of private lettings to young single people.

Shopping incentives

The purpose of the rent restrictions is to prevent private tenants living in unreasonably expensive or overlarge accommodation, or paying 'over the odds' for the property. But because they are not very transparent, they as act as hidden 'trip wires' for Housing Benefit claimants. An alternative would be to design the Housing Benefit scheme in such a way that tenants have an incentive to shop around for reasonably priced accommodation without the need for rent restrictions.

There are various ways in which a 'shopping incentive' could be incorporated into Housing Benefit for *private* tenants. One approach could be to increase social security benefit rates by, say, 25 per cent of the average rent in the area and calculate Housing Benefit on 80 per cent of the claimant's actual rent (instead of 100 per cent of the referred or restricted rent as at present). This type of arrangement would make Housing Benefit for private tenants more like the schemes that operate in other advanced welfare states.

To test the feasibility of this idea, three illustrative schemes were modelled and the results compared with the present system of rent restrictions. It was found that all three shopping incentive schemes would result in far fewer shortfalls than the current system of rent restrictions. Hence most private tenant claimants would have their Housing Benefit calculated on a higher level of rent than is currently the case. They would also be more transparent and simpler to administer, though the extent of these gains would depend upon exactly which of the rent restrictions could safely be removed once a shopping incentive is in place. All three schemes would cost more than the existing one because they would generate far fewer and much smaller shortfalls.

Tax credits

While the Working Families Tax Credit (WFTC) introduced in 1999 reduced the number of low-paid working families dependent on Housing Benefit, there remains a confusing overlap between the two schemes. This could undermine the Government's 'work pays' message, especially in areas with high rents relative to wages.

The Government's proposals to introduce a second generation of tax credit schemes in 2003 provides the opportunity to make more coherent the relationship between tax credits and Housing Benefit. These new tax credits are the Child Tax Credit (CTC) and the Working Tax Credit (WTC) – which replace the WFTC and other tax credits introduced since 1999 – and the Pension Credit (PC).

The latest proposals for the Pension Credit acknowledge the importance of integration with Housing Benefit and of ensuring that entitlement to the new credit does not result in an offsetting reduction in Housing Benefit. It also proposes to significantly ease the means-testing of modest savings, while retaining the administrative simplicity of the 'tariff' used to calculate notional income from savings. There are, however, important unresolved details of the new scheme, particularly with respect to the treatment of earned incomes.

In contrast, the initial proposals for the Child Tax Credit and Working Tax Credit reflect a concern to integrate them with the wider income tax system. This leaves only limited scope for considering how they might be better integrated with Housing Benefit than the WFTC scheme that they will replace. Yet the tax credit proposals have important implications for Housing Benefit. Differences in the treatment of income and changes of circumstance are likely to be problematic for households receiving both tax credits and Housing Benefit, especially for working age families with children. This makes all the more urgent the need for close integration of the two types of scheme, with an approach that maximises certainty and minimises the need for retrospective adjustment of tax credit entitlement.

A housing tax credit

There are two broad approaches that could be taken in attempting to improve the relationship between the tax credits and Housing Benefit schemes. The first would be to fully integrate them by creating a housing tax credit, akin to the childcare tax credit in WFTC. As pre-tax credit incomes rise, the housing tax credit would taper out first, followed in turn by the parent tax credit (CTC or WTC).

This would be relatively simple and substantially reduce the maximum rates of marginal benefit deductions as incomes rise. However, it would extend the tax credit taper further up the income scale. In consequence, the 'poverty trap' would be shallower, but wider affecting a larger number of households, especially working families with children. This problem could be offset somewhat by raising the tax credit taper from the current 55 per cent to, say, 70 per cent. This would still be considerably lower than the maximum marginal deduction rate of 95 per cent that currently affects working families on WFTC, Housing Benefit and Council Tax Benefit.

A partial housing tax credit

The second approach would be to introduce a smaller housing tax credit designed to complement, rather than replace, the current Housing Benefit scheme for people in low-paid work. A flat-rate contribution to housing costs would be added to the tax credit, and households with higher costs would be able to apply for Housing Benefit to help them with the remainder. This would reduce the number of households receiving both tax credits and Housing Benefit.

A similar 'flat rate' amount could also be added to social security benefits, in parallel with reforms to the treatment of eligible rents under the Housing Benefit scheme. At its simplest, a flat rate amount equal to 25 per cent of the average rent could be added to social security benefits and tax credits; and Housing Benefit could then be assessed on 80 per cent of the rent.

In practice, a rather more complex structure is inevitable, in order to respond to the wide variations in rent levels across the country, as well as the different housing requirements of households of different sizes. There are a number of ways in which those issues could be approached. For example, with a relatively generous flat rate credit for each size of household, it would be necessary to supplement it with Housing Benefit only in areas with high housing costs.

Low-income home-buyers

Owner-occupation has grown to such an extent that half of the poorest households now live in this tenure. Compared with low-income tenants, they are more likely to be in low-paid work or retired, and less likely to be out of work.

Because low-income owner-occupiers are not eligible for Housing Benefit, they can be worse off in work than unemployed, despite the introduction of WFTC. This is clearly at odds with the Government's welfare-to-work and 'making work pay' policies.

The inclusion of owner-occupiers in a reformed Housing Benefit, or a partial housing tax credit, would end the current tenure divide in housing support for low-income households. The net cost of including low-income owner-occupiers in a housing credit scheme has been estimated at around £500 million per annum. Any such scheme would need to include prudential measures to limit the levels of mortgage costs eligible for assistance. One approach would be to extend the proposed shopping incentive scheme for private tenants to owner-occupiers' mortgage costs.

About the project

The research built on previous studies of Housing Benefit reform supported by the Foundation and undertaken separately by Professors Kemp and Wilcox. The analysis of the 1999 rent officer data set on rent limits in the private rented sector was undertaken by David Rhodes in the Centre for Housing Policy at the University of York.

How to get further information

The full report, **Housing benefit reform: Next steps** by Peter Kemp, Steve Wilcox and David Rhodes, is published for the Foundation by YPS (ISBN 1 84263 072 5, price £12.95).

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