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

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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.