The Devolution of Housing Benefit and Social Security

The Devolution of Housing Benefit and Social Security: Rebalancing Housing Subsidies in Scotland

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Authors:
Mark Stephens, Janice Blenkinsopp & Kenneth Gibb

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Executive Summary

This report examines the existing Housing Benefit system in Scotland and makes recommendations for its improvement in the light of the Smith Commission's report on devolution.

Housing Benefit was introduced as a national scheme more than 40 years ago. It is demand-side subsidy available to tenants and is subject to a means-test. It is administered by local authorities, but funded directly by the UK Government.

In the 1970s around 80 per cent of housing subsidies took the form of supply-side subsidies to local authority and other social landlords. The purpose of these subsidies was to increase the supply of housing at rent below market levels. Since then, the emphasis of subsidy has reversed. Now approaching 80 per cent of housing subsidy takes the form of Housing Benefit. However, Housing Benefit does little to support the supply of new housing.

How well does Housing Benefit work?

The British Housing Benefit system is designed to prevent the incomes of tenants from falling below the amounts allowed for basic non-housing needs in mainstream social security benefits, such as Job Seekers Allowance. Consequently, if a tenant has no other income, Housing Benefit can meet all of their rent. This is because mainstream social security benefits make no allowance for housing costs.

Housing Benefit plays a vital income support role for more than 60% of social tenants and around a quarter of private tenants. However, its ability to protect people on low incomes has been increasingly undermined by measures that the UK Government believes are necessary to contain its costs, which have risen greatly in real terms.

These include limiting Housing Benefit to the rents charged on the bottom 30% of homes in the private rented sector, and the 'spare room subsidy' which is more commonly known as the 'bedroom tax.' Whereas limitations on the rents that were eligible for Housing Benefit were applied in exceptional circumstances, they are increasingly applied in more routine circumstances. This means that Housing Benefit is increasingly ineffective in performing the task for which it was designed.

It is widely acknowledged that the structure of Housing Benefit limits people's ability to make choices about the housing that they live in, and may actually harm their incentives to look for work, especially when rents are high. These are some of the reasons that the UK Government wishes to absorb Housing Benefit into Universal Credit for people who are of working age. However, Universal Credit is proving difficult to implement and some commentators have questioned whether the Government will succeed in implementing it in full.

Should Housing Benefit be devolved?

Housing Benefit is part of the social security system, which is not currently devolved to the Scottish Parliament. However, Housing Benefit is at the heart of the debate over the greater devolution of powers over 'welfare' that might be devolved to the Scottish Parliament. If Housing Benefit were to be devolved, it would remove the anomaly whereby housing policy is the responsibility of the Scottish Parliament, but Housing Benefit is not.

In order to devolve Housing Benefit, it would be necessary to separate it from Universal Credit. If we assume that Universal Credit will be implemented across the UK, then the Scottish Government would have to devise a new Housing Benefit system to make sure that Scottish claimants were not disadvantaged by being means-tested twice: once for Universal Credit and once for Housing Benefit.

The devolution of Housing Benefit would allow the Scottish Government to diverge from the UK practice, for example by continuing to pay Housing Benefit directly to landlords where tenants would prefer this to be the case, and by putting in additional subsidy to avoid the equivalent of the 'bedroom tax.' However, it would not be possible to conduct a major reform of Housing Benefit because it would still be constrained by the design of the UK benefits system.

In order to redesign Housing Benefit, the Scottish Government would need to have control over at least the means-tested parts of the social security system. This would allow them to gradually introduce an element for housing costs in mainstream social security benefits so that Housing Benefit could be redesigned so that people could make real choices about their housing.

Devolution cannot be separated from the financial arrangements. Substantial devolution of social security would not be sustainable unless the Scottish Government were given the necessary powers of taxation and borrowing. In principle, the UK Government could provide a grant, but that would be against the widely accepted need for the Scottish Parliament to be responsible and accountable for its own decisions.

Devolution of means-tested benefits would therefore need to be matched with the devolution or assignment of a range of taxes. A basket of taxes is preferable to dependence on a single tax, as the risks would otherwise to be too narrowly spread. Borrowing powers would be needed to deal with fluctuations in demand and revenues over the economic cycle. Careful consideration would also need to be given to developing reasonable and prudent risk management processes by which both the negotiations between Scottish and rUK Governments for the initial financial settlement at point of devolution takes place and for indexing annual growth in benefits thereafter (and when this is to be regularly reviewed).

The Smith Commission proposals

The Smith Commission offers only limited control over elements relating to housing in Universal Credit. It would allow the Scottish Parliament to arrange for the housing cost element of Universal Credit to be paid directly to landlords. It would also allow eligible rents to be varied, so allowing the Scottish Parliament to abolish the 'bedroom tax', or reverse a range of the other restrictions introduced since 2010. Any additional expenditure would be financed from Scottish income tax or cuts elsewhere in the Scottish spending programme.

The proposals would not permit the Scottish Government to conduct a redesign of Housing Benefit. The treatment of income and the rate at which Housing Benefit is withdrawn as incomes rise would remain reserved. However, since the design of the Housing Benefit system must reflect the wider social security system fundamental reform of Housing Benefit would require at least all means-tested benefits to be devolved.

The Smith Commission proposals are backward-looking and expedient, and do not allow any strategic overview of housing policy to be adopted by the Scottish Government.

Devolution with a purpose

The decision over what powers are devolved should be based on a clear understanding of what such powers might be used for. Our proposals are founded on the principle of *devolution with a purpose*.

Scotland faces huge housing challenges now and in the future. There are long waiting lists for social housing. One quarter of the population live in fuel poverty, and need to live in more fuel efficient homes. There will be 400,000 more households in 25 years' time than there are today, and three-quarters of them will live alone. The population is ageing, and houses will need to be adapted to facilitate independent living. In short we need to switch the emphasis in subsidy away from the demand-side, and back to the supply-side.

Devolution of the means-tested social security benefits, including Housing Benefit, would provide the basis for devising a new housing strategy to meet Scotland's housing needs. Borrowing powers would be needed to provide investment in housing, whilst over time dependence on Housing Benefit could be reduced. Housing Benefit itself should be reformed to give people the ability to take more responsibility for their housing choices.

Recommendations

- Housing subsidies should be, over time, shifted away from the demand-side and towards the promotion of investment in new and existing housing (while protecting losers in the transition).
- A housing element should be incorporated into mainstream means-tested benefits, and gradually increased.
- Housing Benefit should be redesigned in order to give people more choice and responsibility over their housing.
- Means-tested benefits, including Housing Benefit, should be devolved, subject to sustainable financial arrangements.
- The Scottish Parliament should be given control over a range of taxes, or assigned revenues from them where they cannot legally be devolved, together with sufficient borrowing powers to ensure that these wider powers are sustainable and that the Scottish Government and Parliament are accountable for their decisions.
- As a consequence of the complementary review into Council Tax, the Scottish Government should use its powers to extend the use of its tax base in land and property.
- In the short-run, Housing Benefit should be excluded from Universal Credit in Scotland.

1. Introduction

Tenants in the UK have been eligible for assistance with their housing costs for more than 80 years and a national Housing Benefit system has been in operation for more than 40 of these.

Successive governments have accepted that some form of subsidy for housing is necessary to ensure people on low incomes can afford adequate housing. Homes can be subsidised by reducing the cost of housing at source to make them more affordable for households on low incomes, for example by investing in council houses; or by increasing households' incomes such as through housing benefit to enable them to access accommodation or cope with a temporary loss of income. Demand side subsidies tend to be targeted at an individual and means-tested. They are also portable, allowing a household to move without losing its subsidy. Supply side subsidises help increase the supply of available accommodation, including that at sub-market rents.

Housing Benefit has become the dominant subsidy to housing throughout the UK, including Scotland. Yet the UK Government intends to abolish it, at least for the working age population, as assistance with housing costs is absorbed into Universal Credit. Meanwhile many commentators are concerned that we pay insufficient regard to the supply of housing, and that too much emphasis is placed on Housing Benefit.

This report examines the operation of the Housing Benefit system in Scotland and asks how well it is doing the job for which it was intended, and how it might be reformed to work better.

The report begins by examining the role that Housing Benefit and its antecedents played within the wider context of housing and social security policy. It also examines the principles that underpin housing subsidies and housing affordability. These provide some benchmarks against which the system can be assessed (Chapter 2).

The report then evaluates the Housing Benefit system and records recent reforms and the emergence of Universal Credit that is intended to absorb Housing Benefit for working age households (Chapter 3).

We then examine the reform options for Housing Benefit within the context of the debate on devolution, and relate the reforms to the balancing financial settlement that would be required. The proposals of the Smith Commission are examined. (Chapter 4)

Building on Chapter 4, our preferred structure of Housing Benefit is outlined in the concluding chapter along with an outline of how we get from the current system to the preferred one (Chapter 5).

2. Principles of Housing Benefit and Affordable Housing

Introduction

In this chapter we place the current Housing Benefit system within historical context, and establish the basic principles that underpin affordability, housing subsidy and the design of Housing Benefit. This forms the basis of the evaluation of Housing Benefit that follows in the next chapter.

Background

For much of the 20th century the main thrust of housing policy was support for the provision of new public rental housing, let at below-market rents. The principal Government subsidy took the form of a recurrent revenue support to local authorities. In contrast, capital grants formed the basis of subsidies for housing associations, which became the principal providers of new social rented housing after 1988. At its peak, in the early 1980s, the majority of the Scottish population lived in social housing. Since then, this proportion has halved as public housing has either been sold under the Right to Buy or demolished, whilst private building outstripped new social supply.

The rationale behind subsidising social housing reflected a number of policy objectives, including increasing general housing supply, its affordability and its quality, replacing slums, neighbourhood renewal and – latterly – renovating social rented housing in order to bring it up to modern standards.

In the 1930s local schemes for council tenants operated alongside the emerging social security system, which would meet housing costs of claimants in receipt of means-tested social assistance benefits, but not insurance-based unemployment benefit. In essence this situation was replicated in the post-1945 system, since Beveridge famously failed to solve the 'problem of rent.' The 'problem of rent' was an acknowledgement of the difficulty of incorporating standard housing cost elements into national insurance benefits due to inter- and intra- regional variations in housing costs, and the difficulty that a household has in reducing these costs when faced with a sudden and unexpected drop in earnings (Stephens, 2005).

The consequent inclusion of only a notional allowance for housing costs in national insurance benefits ultimately left the social assistance system to address the problem of households unable to make a contribution to their housing costs. When the national Housing Benefit system replaced the local schemes in the 1970s (which also had the effect of extending support to private tenants), the parallel social assistance system run by the DHSS continued, creating a series of anomalies until a fully 'unified' Housing Benefit system, administered by local authorities but almost entirely funded by central government, was introduced in 1988. In essence this is the system that we have today.

Demand and supply-side subsidies

Supply-side subsidies are obviously associated with newly built housing or renovating existing housing. They have the attraction of producing results directly. Although there is likely to be at least some displacement ('crowding out') of private sector activity, the benefits of social housing can be passed on to future tenants once existing tenants no longer require them. As new construction slowed, and with high levels of inflation in the 1970s and 1980s, the real value of debts diminished, and many local authority housing revenue accounts tended towards surplus. These surpluses were used to 'finance' Right to Buy (the discounted value of properties still generally exceeding the value of debt), and thereafter funded extensive investment in improvements. Explicit recycling of surpluses within the sector through a revolving fund (as occurs in Denmark) was avoided. In some circumstances – often in urban centres of industrial decline, notably Glasgow – the local authority sector remained indebted and renovation depended on very considerable central government subsidy, often directed to housing associations that had taken over ownership and management functions of former local authority housing.

A general criticism of supply-side subsidies is that they are poorly targeted. Clearly this depends in large part on how the housing is allocated. However, the objection carried more force when one-third of the UK and more than half of the Scottish populations lived in public rental housing. The national Housing Benefit system introduced in the 1970s was intended to be part of a general reform of rent setting in both social and private rented sectors. Under this, social rents were expected to rise, whilst poorer tenants would be protected by means-tested Housing Benefit. Whilst the great inflation of the 1970s – and ideological objections - prompted the subsequent Government to abandon rent reform, the strategy was renewed in the 1980s, as social rents were forced upwards by diminished supply-side subsidy and the reach of Housing Benefit grew as a consequence. A similar rationale underpinned the 'new' financial regime for housing associations after 1988 whereby lower capital grants resulted in higher rents.

Moreover, Housing Benefit was intended also to protect poorer private sector tenants from rent deregulation. Given this combination of policy objectives, it is not surprising that the costs of Housing Benefit have risen over time.

Apart from targeting subsidies on those in most need, demand-side subsidies, such as Housing Benefit, are often justified in terms of choice. Whilst a supply-side subsidy is attached to the property, a demand-side subsidy is attached to the household. It is therefore, in principle at least, portable, so empowering a household to find housing of their choice. In turn the exercise of choice by tenants might serve as a means of improving the management performance of landlords. In reality, the extent to which choice can be exercised depends on the design (and generosity) of the housing allowance and the range of landlords that operate in an area. It would also be wrong to assume that there no choice in allocation of social tenancies. In practice, demand and supply-side subsidies operate side-by-side, and it is the balance between them that is important. However, we have moved from a situation in the 1970s whereby in excess of 80% of housing subsidies were supply-side, to one today where approaching 80%[1] of housing subsidies (in Scotland) are demand-side, delivered almost exclusively through Housing Benefit.

Design of Housing Benefit and affordability

There are essentially two notions of housing affordability. The first is the idea that housing costs should not assume too high a proportion of (or burden on) income. This suggests that housing costs should not consume more than a certain percentage (usually 30 or 40%) of income. This approach is widely criticised by academics as being arbitrary and having no theoretical foundation (e.g. Stone, 2006a; b). Nonetheless, it has strong intuitive appeal and has been adopted as the indicator of housing affordability internationally. The second approach identifies housing as being unaffordable when the cost of housing of an adequate size and standard reduces income to a level whereby essential non-housing consumption cannot be met. This is known as a 'residual income' approach. These approaches are reflected in the design of housing allowance systems.

In most north-west European countries, housing allowances have been developed within the context of social security systems that do make an allowance for housing costs within mainstream social security benefits. Housing allowance systems are based on the 'gap' principle whereby, for a given income, the housing allowance meets a certain proportion of rent above a minimum contribution up to a maximum level (Kemp, 2007b). In circumstances whereby unmet housing costs take residual income below the social assistance minimum, the social assistance system itself often steps in. The clearest example of this structure exists in Germany, whereby following the Hartz reforms to the labour market and social security, the housing allowance (*Wohngeld*) is available for people in work or in receipt of social insurance benefits (Koffner, 2007). People receiving social assistance instead receive support for housing costs from the social assistance system.

In contrast, the British Housing Benefit system is designed to prevent residual incomes from falling below social assistance levels after housing costs have been met. This accounts for two unique aspects of Housing Benefit: it can meet 100% of rent, and it can meet all of the marginal cost of housing (so if rent rises by £1, Housing Benefit rises by £1). As incomes (after tax) rise, Housing Benefit is withdrawn at a rate of 65 pence in the pound. However, the commitment to protecting post-rent income has never been unconditional, and its rising costs have led to an increasing array of restrictions. Post-2010, restrictions on eligible rent have intensified.

Conclusion

Housing subsidies can to a greater or lesser extent focus on the supply of new houses, investment in existing ones, or on subsidising individual households. Over the past 40 years the emphasis of Scottish housing policy has been to shift subsidies primarily from the supply-side to the demand side – and this means almost exclusively Housing Benefit. We have seen that the British Housing Benefit system is designed to protect incomes after housing costs. In the next Chapter we examine how well Housing Benefit operates in practice.

1. The Scottish Government spends around £537 million on housing and regeneration, whilst £1.9 billion is spent on Housing Benefit in Scotland.

3. How Well Does Housing Benefit Work?

Introduction

In this chapter we provide an evaluation of Housing Benefit in Scotland. Housing Benefit is intended to fulfil a dual function. In its current form it is designed to fulfil an income maintenance function by preventing incomes from falling below social assistance levels after housing costs are met. To a lesser extent – and in contrast to systems that operate elsewhere – it forms a wider housing affordability function. In addition to these functions, it has a number of ancillary roles, notably protecting the income stream of landlords and providing banks and other investors with sufficient confidence to lend money for housing development. In addition it could have spill-over effects, notably in terms of work incentives. A further criterion by which Housing Benefit might be judged is its financial sustainability, and the government's plans to introduce Universal Credit.

The structure of the Housing Benefit system

The modern Housing Benefit system helping low-income households pay rent, has been in existence in its current format since 1988. The broad structure of its operation was outlined in chapter 2, where it was established that Housing Benefit will meet the whole of a tenant's eligible rent so long as their income does not rise above social assistance levels (roughly the levels provided by means-tested benefits such as income-based JSA). Subject to an earnings disregard, Housing Benefit is then withdrawn at a rate of 65 pence for every pound of income after tax.

Although one national scheme, Housing Benefit is paid in different forms dependent on landlord: Rent Rebates if a council tenant, Rent Allowance if a housing association tenant and Local Housing Allowance if renting in the private rented sector. More limited support for low-income home-owners with mortgages has also been available since 1988 but is not discussed further.[2] This model will be extensively unpicked as a result of the 2012 and associated welfare reforms[3].

The operation of these three types of Housing Benefit is now outlined:

Rent Rebate: This is paid directly into the rent account of a local authority tenant. No money is paid directly to the tenant and these rebates represent the tradition of the differential rent schemes of the 1930s. Overpayments (where too much Housing Benefit has been paid) therefore are also deducted directly from a rent account. Where tenants are in arrears because of an overpayment, no eviction proceedings can be initiated by the local authority in relation to these arrears and must be reported separately from any other arrears.

Rent Allowance: Other than when the tenant is more than eight weeks in arrears, the tenant can choose to have Housing Benefit paid directly to themselves or direct to their housing association by 'direct payments'. Overpayments therefore can be requested from the person who receives the Housing Benefit: claimants, landlord, appointee etc. There is a marked difference in the way overpayments are dealt with for housing association tenants, as when monies are refunded by landlords for an overpayment, they can class the whole of the overpayment as arrears and use this as part of any arrears action. This can obviously have serious consequences for a tenant.

Local Housing Allowance (LHA): The LHA was an important reform introduced by the last UK Government in 2006 in an attempt to increase tenant choice and responsibility. LHA rents are set by a 'Broad Rental Market Area' (BRMA) or 'locality' rent with monthly figures set by the Scottish Government's Rent Service for Scotland and announced monthly by the relevant local authority.[4] LHA allowed claimants to look for suitable accommodation in the locality within their means (Wilcox 2008: 68). Following the introduction of LHA there were a number of changes to this benefit: benefit paid monthly in arrears, paid to tenants, unless they were 'vulnerable' and unable to manage their affairs adequately, or where there were significant arrears which would allow the landlord to request payments direct to themselves after eight weeks.

2. Mortgagors qualifying for income support have been able to receive help with their interest costs subject to a period of delay, a mortgage ceiling and a standard imputed rate of interest. This scheme had its generosity greatly reduced in the mid-1990s on the belief that a private market for mortgage protection insurance would replace it. The scheme became significantly more generous and accessible in the wake of the 2007-08 GFC. Under Universal Credit, there will be a mortgage support element included for working age mortgagors who qualify for Universal Credit.

3. For a clear round up of Welfare Reform changes see Social Security Advisory Committee 'The cumulative impact of welfare reform: a commentary. Occasional Paper No. 12 April 2014 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324059/ssac_occasional_paper_12_report.pdf

4. For current rates of LHA in Scotland see the Scottish Government site: http://www.scotland.gov.uk/Topics/Built-Environment/Housing/privaterent/tenants/Local-Housing-Allowance/figures

Further to this, a size criterion was established and LHA was only paid on the appropriate size of property (capping) (DWP 2010). When LHA was first introduced the eligible rent in a Housing Benefit calculation was set at 50% of median market rents in the relevant BRMA. If the rent was lower than this, the tenant was able to keep up to £15 of the difference; but if the rent was more, the tenant had to make up the difference from other income.

Discretionary Housing Payments: Discretionary Housing Payments are cash limited funds allocated by the DWP to local authorities to help tenants whom they believe to need extra funds to meet housing costs. A claimant must be entitled to Housing Benefit and in need of further financial assistance beyond Housing Benefit. There is no 'right' to DHP and therefore no appeal rights attached to any negative decision. However, claimants can ask initially for a review of their decision and a further review if still not satisfied by a more senior member of local authority staff who was not part of the earlier decision. Discretionary Housing Payments have been bolstered by UK Government to local authorities to mitigate some of the effects of welfare reforms, such as those affecting private rented sector tenants and under-occupancy in the social rented sector. On top of the allocation from UK Government, the Scottish Government has provided an extra £22.8m to councils in 2014-15. Total Scottish funding in 2014-15 is £38m (Berry, 2014).

Protecting residual incomes

The structure of the Housing Benefit system is designed to protect incomes after housing costs have been met. Since mainstream social security benefits do not contain an allowance for housing costs, we can assume that residual incomes have not been protected when Housing Benefit does not meet the whole of the eligible rent, at least (but not necessarily only) in cases where the tenant has no other source of income other than social security.

There are a number of circumstances whereby tenants may not have their residual incomes protected. These include: where eligible tenants fail to make a claim and where there are limitations on eligible rent.

Unclaimed Housing Benefit: The DWP (2012) has estimated that in 2009-10 (the most recently available figures) the 'entitled non-recipients' (ENRs) amounted to £670m - £1,250m in the social rented sector across Great Britain, representing an overall take-up rate of 89–94%. In the private rented sector ENRs were reported to be between £1,130m and £2,000m across Great Britain, making an overall take-up of 75–84%. Some eight per cent of the total ENRs are attributed to Scotland.[5] The DWP believes that part of the reason for non take-up of Housing Benefit was related to people in work assuming they would be ineligible (DWP, 2012: 78, 87).

Limitations on eligible rent: It should be noted that whilst some service charges that are paid as a condition of living in a property are eligible for assistance, Housing Benefit does not cover charges for heating, hot water, lighting, laundry or cooking. Moreover, the eligible or maximum rent has been subject to an increasing number of restrictions, particularly since the austerity programme began in 2010.

Shared accommodation rate: Age-related limitations on eligible rent were introduced in the mid-1990s, since when single people aged under 25 living in the private rented sector have had their eligible rent based on the cost of a room in shared accommodation. In January 2012 this 'Shared Accommodation Rate' was extended to single people aged under 35.

Local Housing Allowance: As we have seen, the maximum rent under LHA was 50% of median market rents in the BRMA, but this has been reduced to 30%, and will increase only in line with CPI. (The £15 incentive to rent accommodation under the local ceiling was withdrawn in 2010.)

Spare room subsidy (bedroom tax): Social renters' Housing Benefit is reduced by 14% for one spare room and 25% for more than one from April 2013. The bedroom tax is currently being mitigated at the expense of the Scottish Government by means of topping up Discretionary Housing Payments.

Household benefit cap (all tenants): This places a limit of £500 per week on the benefits that can be received by families and of £350 for single person households (from October 2013). The cap is applied to a list of eleven 'specified benefits' including main working age benefits, Housing Benefit but also Child Benefit and Child Tax Credit. Where a claim for Housing Benefit is in payment, the cap will be applied to this benefit first, where Housing Benefit is not in payment the cap will be applied to the main income replacement benefit in payment. Where Universal Credit is in payment, the cap will apply to the total Universal Credit payable.

Non-dependent deductions (NDDs, all tenants): Previously frozen NDDs have been increased to catch up with inflation since 2002-11 during which time they were fixed (commencing April 2011). A flat rate NDD will apply under Universal Credit.

Work incentives

Housing Benefit has complex implications for work incentives arising from its unusual status as both an out-of-work and in-work benefit.

Housing Benefit protects after-housing cost incomes of people who are unemployed, often meeting the whole of their rent. The out-of-work income after housing costs for someone who is unemployed can be conceived as representing the very lowest 'reservation

5. DWP cumulative data 08/09 and 09/10

wage' below which someone would not be prepared to work. In reality, that reservation wage is likely to be higher than the level of out-of-work benefits because the rewards from work should be in some way proportionate to the effort required.

Since Housing Benefit is means-tested it might be expected to contribute to an 'unemployment trap' particularly since most 'earnings disregards' (earned income that is ignored when assessing benefits) have been allowed to decline in real terms. An 'unemployment trap' exists whereby someone might be worse off in work than out of work (a 'hard' unemployment trap) or insufficiently better off in work to make it worthwhile (a 'soft' unemployment trap). The redesign of the social security system in 1988 greatly reduced the hard version of the unemployment trap, but it persisted where a loss of passported benefits, or non-housing costs associated with employment (e.g. travel or child care) lead to people being worse off in work. The availability of Housing Benefit to people in work, albeit on a means-tested basis, lessens the work distinctive – provided that people in work claim it.

The overall financial incentive to work depends on the inter-action of Housing Benefit with tax, national insurance, tax credits and other means-tested benefits, and crucially take-up of Housing Benefit among the in-work population. These can lead to very high rates of withdrawal for people in work: the so-called 'poverty trap'. In 2012/13 people living in households in receipt of Housing Benefit but not tax credits can be left with as little as 10 pence left out of each pound earned (with Housing Benefit withdrawal accounting for 24 pence of the loss) (Tunstall et al, 2013, Table 2). Those also receiving tax credits (with Housing Benefit accounting for 10 pence of the loss) (ibid.). It is important to note that how far up the income scale Housing Benefit affects work incentives depends on the rent. The higher the rent (up to eligibility limits), the greater the entitlement to Housing Benefit, and eligibility will go further up the income scale.

However, the key determinants of work incentives are:

- Level of housing costs eligible for Housing Benefit. The higher the housing cost the greater the reliance on Housing Benefit, the higher the reservation wage, and the higher the earnings are required to escape the poverty trap. Low rents should thus improve work incentives.
- Earnings disregards. These allow for initial earnings to be excluded from the means-test allowing the individual to retain their earnings. This affects incentives for entry into the labour market, particularly at the lower end.
- Taper: Reductions in the taper (rate at which benefit is withdrawn) improve work incentives for those in receipt of benefit, but increase the numbers who qualify for it and hence are subject to the poverty trap.

Evidence of the effect of Housing Benefit on actual behaviour is less clear. Broadly, it suggests that purely financial incentives are reduced by lack of knowledge of the system (Tunstall, et al, 2013). Moreover, the administration of Housing Benefit creates uncertainty and can act as a deterrent to taking (particularly) short-term or insecure employment (Stephens, et al 2010). (Universal Credit intended to address this issue.)

Reliance on Housing Benefit and its Costs

In 2013-14, just under 480,000 tenants in Scotland claimed Housing Benefit (Table 1), an increase from the level of 426,332 in 2008-09. In that period the biggest growth has been in private renting claimants who increased in size by nearly 58%. Between 60 and 65% of social tenants receive Housing Benefit, compared to between 25 and 30% of private renters (Table 1). So although the numbers of private tenants who have claimed Housing Benefit has risen, the proportion has fallen.

Table 1: Scotland: Housing Benefit Claimants, 2008-09 to 2013-14

Year	LA	RSL	PRS	Total
2008-09	197,893 (60%)	165,799 (62%)	62,640 (25%)	426,332
2009-10	203,956 (63%)	171,495 (64%)	74,701 (27%)	450,152
2010-11	206,363 (64%)	175,987 (65%)	86,652 (30%)	469,002
2011-12	205,492 (64%)	177,991 (65%)	92,809 (31%)	476,291
2012-13	205,822 (65%)	179,932 (65%)	97,928 (28%)	483,687
2013-14	200,925 (63%)	178,214 (64%)	98,847 (27%)	477,986

Source: Absolute numbers: DWP database – data provided/assembled by Duncan Gray at Shelter. Percentages are estimates based on stock in *Housing Statistics for Scotland*.

Table 2 shows forecasts for Housing Benefit expenditure for the current financial year and estimates a total cost of £1.907 billion for Scotland and suggests significantly different costs per claimant in each housing tenure: £3,507 (council) and £3,645 (RSL) but fully £5,130 for private tenants.

Table 2: Housing Benefit Expenditure, 2014-15 forecast, Scotland

Tenure	Claimants (000s)	Total Cost (£m)	Cost per claimant (£)
LA	196	701	3,507
RSL	186	678	3,645
PRS	103	529	5,130
Total	485	1,907	3,933

Source: HM Treasury (data provided/assembled by Duncan Gray at Shelter Scotland)

Table 3: Housing Benefit Expenditure, Scotland, real terms (14-15 prices), 2003-04 to 2014-15, £m rounded

Year	LA rent rebates	RSL/ PRS Rent Allowances	Total
2003-04	694	786	1,480
2004-05	697	792	1,489
2005-06	692	801	1,493
2006-07	688	817	1,506
2007-08	670	842	1,512
2008-09	672	907	1,579
2009-10	701	1,017	1,718
2010-11	714	1,073	1,787
2011-12	709	1,109	1,818
2012-13	717	1,144	1,861
2013-14 (estimate)	681	1,115	1,796
2014-15 (forecast)	678	1,124	1,802

Source: DWP database (data provided/assembled by Duncan Gray at Shelter)

Finally, Table 3 charts the real terms increase in Scottish Housing Benefit since 2003-04. The total has risen from £1.48bn to more than £1.8bn - an increase of more than 21% in real terms. While the cost of local authority rent rebates fell in real terms in this period, rent allowances, covering housing association and private tenants, grew by 43% in real terms.

In Scotland, one in four households received financial support to help pay for their rent or council tax during 2012/13 in the form of means tested Housing Benefit or Council Tax Benefit (CTB). Scottish councils paid out £2.17 billion in Housing Benefit/CTB awards in 2012/13. Scotland received £47.6 million in funding from the Department for Work and Pensions (DWP) to deliver/administer Housing Benefit/CTB services. This represents a 5.3% increase from 2011/12 in Housing Benefit/CTB awards paid out and a 4.8% reduction in overall funding[6] (Audit Scotland 2013). Philips (2013) states in an Institute for Fiscal Studies report that of the number of total claims in Scotland for 2013/2014, 77.6% were from the social rented sector and 22.4% from the private rented sector.

Universal Credit

Universal Credit is the UK Government's flagship welfare reform arising from the Welfare Reform Act 2012. It is intended to replace six means-tested benefits with a single Universal Credit for the working age population. It is intended to simplify the system for claimants, and establishes a single taper and clearer job search requirements to improve work incentives. Housing Benefit is one of the six means-tested benefits to be included in Universal Credit. Paid monthly in arrears direct to the claimant, Universal Credit payments are meant to mimic salaries, placing greater responsibility on claimants and increasing awareness of budgeting for priorities such as rent.

The implementation of Universal Credit has been beset with problems, many of them IT-related, and it is running well behind schedule. Claims for Universal Credit so far have been restricted to new claimants, for those who are single or couples without children. However, as announced on 25 November 2014, claims for (some) families with children will be possible in the North West of England. Only certain parts of the UK were chosen for the initial roll-out, with Inverness being the only area in Scotland. In October 2014 fewer than 18,000 of the estimated 7 million claimants are expected to have been absorbed into the scheme by December 2019[7] – that is 0.25% of the total (National Audit Office, 2014). The DWP has been forced to 'reset' its timetable for implementation. For example, 'legacy' Housing Benefit claims have been put back by a year and will not begin to be transferred until January 2018 (ibid.). It is understood that the DWP is subsidising local authorities to the tune of £21-41 million to employ temporary and fixed-term staff in order to continue to administer Housing Benefit whilst they wait for Universal Credit (Wernham, 2013).

6. From April 2008, the Accounts Commission took over the responsibility for auditing Housing and Council tax benefit (HB/CTB) services in Scotland from the Benefit Fraud Inspectorate. Detail of latest Audit Scotland audit can be found here: http://www.audit-scotland.gov.uk/docs/local/2013/hb_130902_perf_audit_update.pdf

7. These represent 93% of the total entitled to Universal Credit.

Some of the experts we consulted doubted whether Universal Credit would ever be implemented. The Major Projects Authority has rated Universal Credit as 'amber/ red' which means that it regards 'successful delivery of the project is in doubt, with major risks or issues apparent in a number of key areas.'[8] A former DWP Chief Economist recently wrote that the next Secretary of State will need to make the decision, 'Cut your losses and cancel universal credit, or press ahead despite the risks?' (Portes, 2014)

Conclusion

The current Housing Benefit system was designed to provide a safety net for tenants on low incomes, with less emphasis placed on improving affordability for people who are not dependent on baseline social security benefits, but nonetheless live on modest incomes. It accords assistance to more than 60 per cent of social tenants and more than one-quarter of the growing number of private tenants. It therefore provides vital assistance to a substantial proportion of the tenant population and around one-quarter of all households.

The commitment to protecting residual incomes has never been absolute, but has declined substantially in recent years. Age restrictions in the private sector, and the reduction of eligible rents under LHA to 30% of the median, combined with uprating by CPI, indicate that the Government is quite accepting that housing costs should be allowed to reduce incomes below social assistance levels in many, rather than in only exceptional, circumstances. This reality is reinforced in particular by the 'bedroom tax' in the social rented sector, although this is currently mitigated in Scotland. In contrast, the increase in contributions expected from non-dependents, after a long period of their being frozen, has not been generally mitigated. These non-dependent deductions were a documented source of family strife and hardship in the 1990s.

The pressure to limit eligible rents has been given considerable impetus by the growing cost of Housing Benefit. Although this is the logical outcome of reviving the private rented sector, it is nonetheless a reversal of the commitment to protect poorer tenants when private rents were first deregulated in 1989. Whilst public opposition to Housing Benefit restrictions has been focussed on the 'bedroom tax', other changes which are also the source of hardship have occurred with little protest. The sustainability of Housing Benefit must therefore be questioned.

Its design, too, is peculiar, though sits logically within the structure of the wider social security system which makes no provision for housing costs. Features of the system seem likely to produce disincentives to work, although the actual effect depends on a series of inter-relationships, not least with rents. Yet few would regard the design of Housing Benefit as being ideal.

But Housing Benefit, at least for the working age population, is supposed to disappear as it is absorbed into Universal Credit. Many social landlords are concerned by the prospect of the end to direct payment to themselves, fearing that many tenants will not pay the rent. Universal Credit is intended to provide a simpler system and one that removes some disincentives to work. But it is running behind schedule and is mired in serious implementation problems to the extent that some observers doubt whether it will ever be implemented in full.

Meanwhile the controversy over the 'bedroom tax' has placed Housing Benefit at the heart of the debate of the devolution of more powers over 'welfare' to the Scottish Parliament. What is and is not possible in the design of Housing Benefit is closely linked to the constitutional settlement. Consequently, in the next Chapter we examine the possibilities for devolving Housing Benefit and the wider social security system.

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8. 'HM Treasury admits to potential £663m of universal Credit cost write-off', *Computer World*, 11/12/14 http://www.computerworlduk.com/news/public-sector/3590699/hm-treasury-admits-potential-663m-of-universal-credit-it-cost-write-off/

4. The Devolution of Housing Benefit and Social Security

Introduction

Housing Benefit is at the centre of the debate over the devolution of more powers over 'welfare'[9] to the Scottish Parliament. In this chapter we examine the different merits of different possibilities for devolution of Housing Benefit and the wider social security system. We place much emphasis on the need to match the powers that are devolved with matching financial arrangements. We go on to examine the Smith Commission's proposals against the framework established earlier in the chapter.

Reform Options

The individual political parties published proposals to be considered by the Smith Commission, which was established to consider the additional powers for the Scottish Parliament that the unionist parties indicated would follow a 'no' vote in the referendum. The unionist parties' positions have been summarised in a Command paper published by the UK Government (HM Government, 2014). The Scottish Government's position is set out in its own paper (Scottish Government, 2014).

The Scottish Government *'believes that Scotland should have full responsibility for its welfare system'* and that the Scottish Parliament *'should take responsibility, over time, for social protection in its entirety'* (SG, 2014, p. 23). Although Housing Benefit is not named specifically, it is clear that the Scottish Government wishes to attain full control over Housing Benefit, along with all other social security benefits.

The UK Government's paper suggests three approaches to the devolution of social security:

- 'devolving a portion of the expenditure relating to claimants in Scotland of a particular benefit, alongside the power to either vary the rate and rules or operate a separate benefit with a different rate and eligibility criteria, or alternatively to reallocate that funding to another area;
- 'devolving a proportion of the expenditure on a specific welfare service that relates to claimants in Scotland, alongside a statutory responsibility to deliver that service in Scotland, and potentially further powers to either increase or scale back provision of that service; or
- 'powers to 'top up' benefits above the level set by the UK Government.'

(HM Government, 2014, p. 34)

The Conservative position in general was to be more supportive of devolution of items of welfare where they are related to a competence that is already devolved. Housing Benefit falls into this category as it "may play a role in the development of housing policy." (quoted, HMG 2014, p. 35). However, the party's commission noted that Housing Benefit is being absorbed into Universal Credit and *'it is likely to be administratively highly complex (and expensive) to disentangle the housing benefit element of Universal Credit for Scottish recipients in order to devolve responsibility for that one component of Universal Credit to the Scottish Parliament. None the less if it can be done there is a case for devolving housing benefit.'* (ibid.). The Labour position was simply that Housing Benefit should be devolved.

Public opinion appears to be strongly supportive of extensive devolution of both social security and tax powers.

Table 4: Public opinion and devolution of tax and social security

	Yes	No	Don't know
YouGov (n = 1,078; 27-30 October 2014)			
Income tax	67	25	8
Other taxes like inheritance tax, corporation tax and capital gains tax	67	24	9
Working age benefits like Housing Benefit and JSA	71	22	7
State pension	47	45	8
Panelbase (n = 1,049) 29 Sept – 1 Oct 2014			
Control over all areas of govt policy except defence and foreign affairs ('devo max')	66	19	15
Control over welfare and benefits system	75	17	8
Control over policy regarding the state pension	65	25	10

9. 'Welfare' is an American term that carries stigmatising connotations that were meant to be banished by the introduction of a 'social security' system in the UK based on entitlements after the Second World War. It has become increasingly used in the UK, notably with reference to devolution. We prefer the term 'social security' and use 'welfare' only to reflect the terms in which the debate has been framed.

Given this context, there are a wide range of possibilities between the status quo and full devolution of social security benefits, which are summarised in Figure 1.

Figure 1: Reform options

These are outlined briefly, in turn, and are followed by a brief summary of the financial context.

Remove Housing Benefit from Universal Credit and allow administrative flexibility

Housing Benefit would be taken out of Universal Credit in Scotland and administered separately. In order to preserve the uniformity of entitlement across Great Britain, it would follow the same eligibility rules as the rest of Great Britain, but the Scottish Government would be able to vary its administration. An obvious area where administrative variation might be applied would be to allow greater use of direct payments to landlords; another might be the frequency of payment. This option is likely to have minimal financial implications, and would allay one concern expressed by social landlords.

Comment: It might be possible to operate this option within the administrative structures established for Universal Credit, but it would offer little in the way in autonomy for the Scottish Government. It might be recalled that the Scottish Office used to be responsible for Rent Rebates (i.e. Housing Benefit for council tenants).

Discretionary top-up funding

This would involve leaving Housing Benefit as part of Universal Credit and operated as a Great Britain-wide scheme. However, the Scottish Government would be able to enhance benefits and perhaps introduce new ones. Such a structure could operate on the principle that the GB scheme sets a floor for entitlement, with the Scottish Government able only to enhance entitlements should it wish to do so.

For example, the temporary discretionary element represented by Discretionary Housing Benefit (£38 million) introduced by DWP to ease transition following austerity-related cuts, and now enhanced by the Scottish Government in order to mitigate the Bedroom Tax, could continue. The implication is that it would be funded by the SG in the medium/ long-term.

Comment: A scheme such as this would allow some variation in Housing Benefit within the general structure of social security. If top-ups were essentially discretionary, then they might operate in parallel to the 'official' Universal Credit scheme, in much the same as Discretionary Housing Payments operate now. A more formal arrangement would be likely to be more cumbersome, and involve the construction of an interface with Universal Credit. It might well be that this would prove to be 'administration heavy' in relation to entitlements.

Devolve the parts of Housing Benefit not absorbed into Universal Credit

Housing Benefit will disappear for most of the working age population as it is absorbed into Universal Credit. This is a process that is taking much longer than the UK Government anticipated. Many experts believe that it will take longer to complete than the UK Government envisages even on its revised timetable, and some doubt whether it will ever be achieved. Nonetheless, if we assume that it will be achieved, this would leave primarily pensioners as potential recipients of Housing Benefit. A minimalist approach to devolution would involve devolving the remaining elements of Housing Benefit. However, it is expected that Housing Benefit for new claimants of Pension Credit will be absorbed into Pension Credit from 2017.

Comment: Devolution of Housing Benefit on this basis would meet any commitment to its devolution only in the narrowest and most literal of terms. Since it holds no obvious advantages, this option offers little attraction.

Devolution of Housing Benefit outside Universal Credit

Under this option, responsibility for the design of Housing Benefit would be devolved. In principle this would provide the Scottish Government with the ability to redesign Housing Benefit, and to align it with housing policy. It would add around 6% to the Scottish Government's spending.[10] However, the option presents clear constraints. One is that in practice reform options would be constrained by the structure of the wider social security system which would remain a reserved competence.

The arrangement would require Housing Benefit to be disentangled from Universal Credit. It is not obvious why this should be unduly complex, at least administratively, since housing costs are a discrete part of the Universal Credit calculation, and assessment takes place (as now) on the basis of income before rent is paid. (In other words, entitlement to Housing Benefit does not affect other parts of the Universal Credit calculation.)

10. Expert Group on Welfare (2013) *Report* gives Housing Benefit spending in Scotland as £1.7bn in 2011-12. The budget for that year was £29.5bn.

The simplest way in which this could operate is for households to be 'passported' for full Housing Benefit whenever they receive 'baseline' Universal Credit, in much the same way as happens now with benefits such as JSA. The DWP would simply inform the local authority of this position.[11] The Scottish Government would be able to determine rules on eligible housing costs, tapers, etc.

However, Housing Benefit could not simply be operated as it is now for people not in receipt of full Housing Benefit. The calculations in Appendix A show that the separate treatment of Housing Benefit from Universal Credit could lead to substantial losses for claimants, although the disadvantage reduces as rents rise. This arises from the much higher earnings disregard applied to claimants without housing costs than those with them in Universal Credit. In order to prevent Scottish tenants from being disadvantaged through the separation of Housing Benefit from Universal Credit would therefore require Scottish Housing Benefit to be redesigned.

Further, any assessment of this option cannot be separated from its financing. In an earlier discussion paper, written within the context of the Calman Commission, Gibb and Stephens (2012) suggested that the financing of this option would require a lump sum to be added to the Scottish block, and that its financial consequences would depend on the terms of the settlement. Given the demand-led nature of Housing Benefit expenditure, this would entail some financial risk being transferred to the Scottish Government. Clearly, the reform possibilities being considered by the Smith Commission include a wider and more flexible tax base and borrowing powers.

Comment: There is precedent for an arrangement such as this. Council Tax Benefit (or 'reduction' as it is now known) has been excluded from Universal Credit, and devolved to local authorities in England and to the Scottish Government. However, the degree of autonomy offered by this option may be less than might at first appear to be the case, because the Scottish Housing Benefit system would need to operate within the context of the GB-wide social security system. However, there would be 'internalisation' of the effects of altering housing policy or Housing Benefit. For example, the Housing Benefit costs of increasing social rents would be borne by the Scottish budget, while the savings from limiting private rents would benefit the Scottish budget. However, a full assessment of this option cannot be made without also considering the nature of the financial settlement.

Devolution of all non-contributory benefits

Clearly, the design of Housing Benefit is affected by the way in which the wider social security system operates. It accounts for 10.7% of all social security spending (including tax credits) in Scotland, the third largest item after the State Pension (39.1%) and tax credits (14.0%).

The devolution of all social security benefits (including tax credits) is considered below. However, in view of the complexity of disentangling accrued entitlements to insurance-based benefits generally, and the state pension in particular, the devolution of non-contributory benefits whilst leaving insurance-based benefits as a reserved matter should be considered as an option in its own right.

Table 5: Expenditure on DWP and related benefits and tax credits[a]

Benefit	£m	Col %
Attendance Allowance	481	3.0
Bereavement Benefit/ Widow's benefit	59	0.4
Carer's allowance	153	0.9
CT benefit	384	2.4
DLA	1,372	8.5
Of which children	109	
Of which working age	774	
Of which pensioners	488	
ESA	381	2.4
Housing Benefit	1,728	10.7
Incapacity Benefit	564	3.5
Income Support	670	4.1
Of which on IB	418	
Of which lone parents	190	
Of which carers	34	
Of which others	28	
Industrial injuries benefits	93	0.6
JSA	461	2.8
Maternity allowance	24	0.1
Over 75 TV licenses	49	0.3
Pension credit	752	4.6
Severe disablement allowance	97	0.6
Of which working age	75	
Of which pensioners	21	
Stat maternity pay	197	1.2
Winter fuel payment	188	1.2
State pension	6,325	39.1
Tax credits	2,200	14.0
TOTAL	13,978	100

Note: (a) 2011-12, except tax credits, which relate to 2012-13

Source: McCrone (2013), except tax credits = DWP Scotland Analysis (2012-13)

11. We are grateful to Steve Wilcox for this suggestion.

Apart from pragmatic concerns relating to accrued entitlements, there are some 'in-principle' reasons for leaving national insurance benefits as a reserved matter, whilst devolving non-contributory benefits. National insurance benefits, particularly the state pension, have stronger connotations of entitlement and citizenship that are often seen as being part of the British 'social union'. There is also a stronger tradition of discretion and localisation relaying to means-tested benefits. Although this has greatly diminished over the past 40-50 years, it has returned in the form of the 'localisation' (and devolution) of assistance with Council Tax. Non-contributory, but non-means-tested benefits might be seen as occupying an intermediate position.

Comment: The essential trade-off presented by this option is between the (enhanced) degree of freedom to shape housing and Housing Benefit policy presented to the Scottish Government against the financial resources and risks associated with it. Financial resources are discussed separately below. This option would offer considerably greater freedom than is implied by devolving Housing Benefit by itself, because it opens up the possibility of including an element for housing costs within mainstream benefits. It would also mean that the Scottish Parliament would be able to remodel means-tested assistance for home-owners, which currently operates outside Housing Benefit. The non-devolution of insurance-based benefits would not inhibit the redesign of means-tested benefits because the generosity of means-tested benefits does not impact on entitlement to insurance-based benefits.

Devolution of all social security benefits and tax credits

The freedoms and complexities associated with the full devolution of social security require little further elaboration over the discussion of the devolution of non-contributory benefits. It should be noted that the State Pension alone accounts for 39.1% of expenditure on social security including tax credits in Scotland, and DWP benefits are equivalent to approaching 50% of the total budget currently controlled by the Scottish Parliament.[12] This is the option favoured by the Scottish Government and represents 'devo max'.

It should be noted that the practical barriers to establishing a Scottish national insurance fund (as operates in Northern Ireland) is lessened by the practice of paying for this year's benefits from this year's contributions. Moreover, a pragmatic case for devolving national insurance as well as non-contributory benefits might be based on insurance benefits being the one place where meaningful reform could begin without major disruption. For example, a route to reform might be based on a rebuilding of the national insurance element in social security, particularly among the working age population, whereby enhanced benefits would accrue from additional contributions – a 'something more for something more' principle.

Comment: The devolution of all social security benefits would provide the Scottish Government with the greatest freedom to implement far-reaching reforms stretching across the social security and housing systems. The devolution of national insurance benefits would create an additional administrative challenge, although the pay-as-you go nature of finance makes this less complex than if a genuine insurance system were in place now. It would seem deeply problematic, however, to devolve only working age insurance benefits as both these and pensioner entitlement are dependent on the same contributions. The financial resources and risks associated with it are fundamental to its assessment. If the available resources are diminished then so too are freedoms to devise policies, and trade-offs would become more acute.

Financial settlement

Currently, the Scottish Government's activities are financed through a block grant, variations in which are largely determined by the population-based Barnett formula. The Scotland Act 2012 introduces limited borrowing powers for both capital and current spending, and income tax will be partially devolved from April 2016. As a consequence the Scottish Parliament will be responsible for raising 16% of tax receipts in Scotland which is equivalent to 22% of devolved expenditure and 13% of all public expenditure[13] (Scottish Government, 2014, p.14).

One model for the greater devolution of social security would involve the inclusion of an allowance for social security within the Scottish block grant, with any increase in generosity funded by Scottish taxpayers. Gibb and Stephens (2012) highlighted some of the difficulties with this approach, namely that the bloc is designed to fund activities whose expenditure requirements are relatively stable in the medium term and predictable. These normally fall within the Treasury's regime of 'Departmental Expenditure Limits' (DEL). In contrast, social security is a demand-led expenditure, elements of which vary over the economic cycle. Housing Benefit, has also exhibited market-related pressures. Social security falls within the remit of 'Annually Managed Expenditure' (AME), to reflect this instability, although the UK Government intends for it

12. The Expert Group on Welfare (2013) *Report*. Table 3.1 gives total expenditure on DWP benefits in 2011-12 as £14 bn. Scottish Government (2014) Draft Scottish Budget, Table 1.01 gives total DEL spending as £29.5bn in 2011-12. The Scottish Government (2013) *Scotland's Future*, p. 75 suggests a budget for 2016/17 in which 'reserved social protection' equates to 50% of public expenditure (including debt interest) in Scotland.

13. Scottish Government (2014) *More Powers for the Scottish Parliament*, October

14. Neither the existence of household-level or general social security expenditure caps need impede devolution, provided that the Scottish Government funded the difference.

to become subject to a general cap.[14] In principle such a sum might be reviewed from time to time, to reflect costs and the ability to pay, which would be consistent with risk pooling across the UK. This arrangement would become more problematic the more a Scottish social security system evolved and diverged from its rUK counterpart, as the baseline would become ever more difficult to detect.

However, it is widely accepted that increased powers to the Scottish Parliament should be matched by increased financial responsibility. This implies financing Scottish services from Scottish taxes, or at least a much greater dependence on self-finance. It is axiomatic that such an approach to funding devolved social security implies a reduction in the risk pool.

Table 6: Main Taxes and their Revenue 2012-13, Scotland, £m

Tax	£m	Col %
Income tax	10,865	27.2
Corporation tax (excludes NS)	2,872	7.2
CGT	292	0.7
NICs	8,521	21.3
VAT	9,347	23.3
Fuel duties	2,258	5.6
Stamp duties	472	1.2
Non Domestic Rates	1,981	5.0
Council tax	2,006	5.0
Inheritance Tax	243	0.6
Tobacco duties	1,128	2.8
Total	39,985	99.9

Source: GERS, Table 3.1

The unionist parties have outlined their proposals for the further devolution of taxes or assignment of territorial revenues accruing from them. There is agreement among these parties only that there should be (to varying extents) greater devolution of income tax. However, as Table 2 indicates, income tax accounts for only 27% of revenue, and not much more than 60% of social security and tax credit spending. VAT accounts for almost one-quarter (23.3%) of tax revenue and National Insurance Contributions for more than one-fifth (21.3%). Between them these three taxes account for more than 70% (71.6%) of tax revenue in Scotland excluding North Sea revenues, which are estimated at £11.6 billion in 2008-09 and £5.6 billion in 2012-13.[15] They exceed social security and tax credit spending by some 75%. It is legally possible to devolve each of these taxes apart from VAT, which must be levied at a single rate within a country under European Union laws. However, Scotland could be allocated a territorial share of VAT receipts.

The financial settlement is highly pertinent to the devolution options outlined for two reasons:

- the ability to fund Housing Benefit/ social security depends on the size of the tax base available to the Scottish Government; and
- the greater the devolution of responsibility for social security, the greater the flexibility of resources (both tax and borrowing) that are required by the Scottish Government to mitigate the risk of paying for demand-led expenditure commitments from cyclical tax receipts.

In terms of thinking through the possible implications of different devolved welfare benefit decisions, there is no precedent for this other than to draw analogously on actual and proposed taxation/revenue reforms and how they will impact on the budget and to attempt to apply principles from what we know about Block Grant Adjustment (Nicol, 2014, Bell and Eiser, 2014; Bell, 2014).

The decision to devolve a benefit such as Housing Benefit implies that there will be a transfer of funds equal to a negotiated amount that the UK and Scottish parliaments consider fair in terms of risk management and that this will then be indexed in some way for a period of time before it is reviewed. Unlike devolving revenue, this will increase Scottish resources, but presumably any extra spending will have to be met by the Scottish block (potential savings would presumably be retained). It is further presumed that the Housing Benefit funding would be treated as Annually Managed Expenditure (AME) rather than explicitly as part of the Departmental Expenditure Limits (DEL) - although they are clearly linked. AME cannot be planned but has to be set annually and welfare benefits are also subject to a cap (Bell, 2014). This suggests that there will need to be a closer relationship between Scotland and the UK over the budget transfers.

Bell's (2014) written evidence to the welfare reform committee also suggests that the annual process would be analogous to the block grant adjustment (BGA) associated with the new Scottish rate of income tax (SRIT) system. He notes that in these circumstances Scotland would carry the risk or reward of its tax base growing at a slower or faster rate than that of the rUK. Similar risks/ rewards are attached to secular changes in underlying needs (driven, for example, by the proportion of eligible households, or trends in rents). Such risks, whilst part and parcel of meaningful devolution, should be minimised in any negotiated agreement.

15. GERS Table 2.3 Meanwhile the recent fall in the price of oil has been widely noted.

Comment: The essential point is that the devolution of Housing Benefit or wider social security must be assessed in the light of the *affordability* and sustainability of the transfer of powers and the tax and borrowing powers that are devolved. The principle is that the Scottish Government must have the resources available to match the responsibilities accrued, including mismatches caused by the economic cycle, and long-term structural demands (arising from demography, for example).

There appears to be no agreement on how the block grant should be adjusted to reflect the devolution of tax powers under the Scotland Act 2012.[16] This would be of fundamental importance if much more significant expenditure items such as social security were to be devolved. Whether it was based on the previous year's expenditure, a cyclically-adjusted sum, or a sum reflecting long-term demand could – and almost certainly would – make a very significant difference to the resources available to the Scottish Government. The reverse pyramid below (Figure 2) outlines the financial options that seem most suitable for each of the reform options.

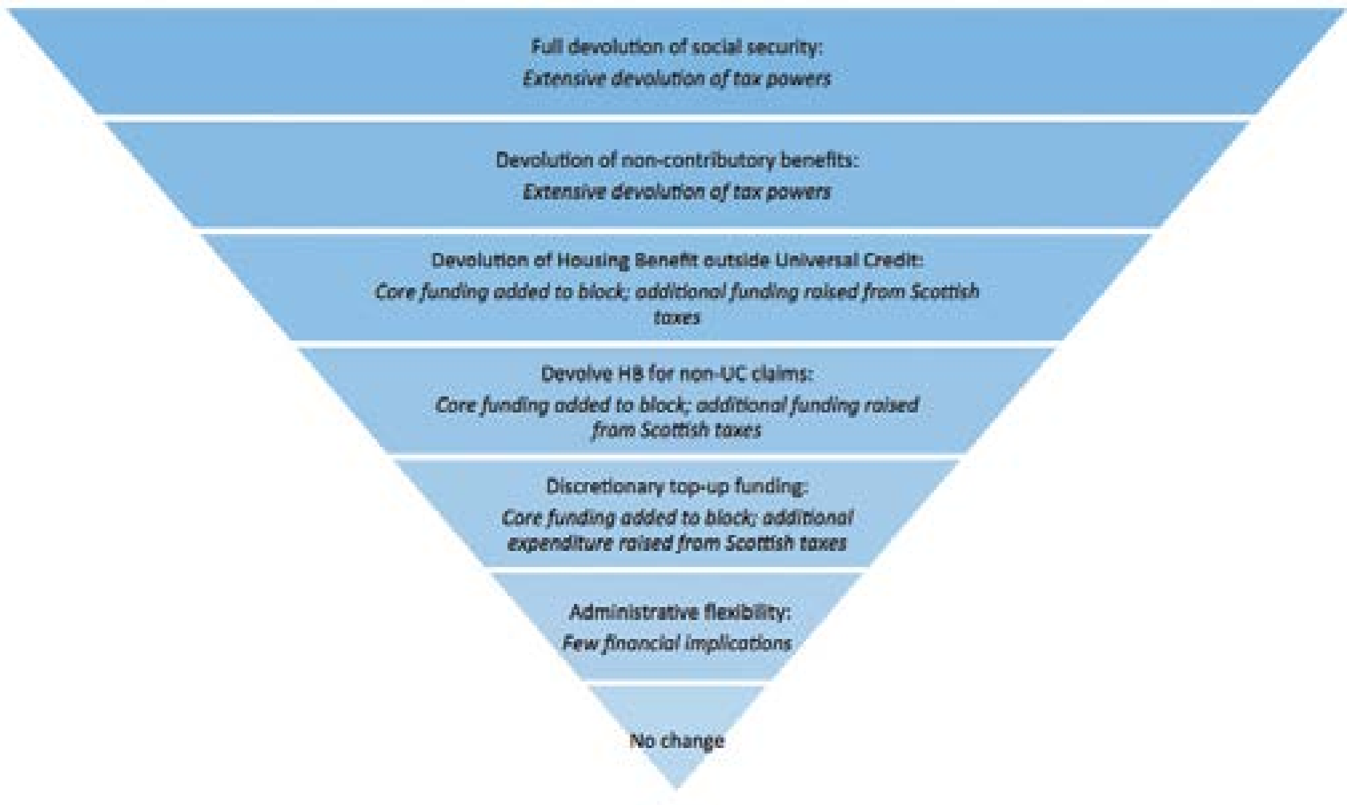
The relatively limited options of devolving Housing Benefit for non-Universal Credit claims and allowing discretionary top-up funding and the devolution of non-Universal Credit claims could be managed largely through additions to the block for the core funding elements, whilst any additional expenditure should be raised from Scottish taxes. Since these elements are relatively small, significant devolution of tax powers would not be required. Even the devolution of Housing Benefit outside Universal Credit could be managed in this way, for the reason that options for reform would be severely curtailed by the design of the wider social security system. This does not negate the importance of the arrangement negotiated between the UK and Scottish Governments, and the risks that this entails. However, an agreement for periodic review could reduce some of the concerns raised by Gibb and Stephens (2012) .

Whilst it would be possible to fund the devolution of non-contributory benefits and full social security devolution on the same principle of block grant plus top up from Scottish taxes, the requirements of transparency, accountability and cyclical risk suggest that such an extensive transfer of responsibility should be funded through a widened tax base with borrowing powers to deal with cyclical fluctuations in demand and revenues. The UK Government might wish to stipulate that borrowing be used only for counter-cyclical purposes on the grounds of macro-economic management.

The Smith Commission proposals

The Smith Commission (2014) reported on 27 November with its proposals for *'an enhanced devolution settlement for Scotland [that] will be durable, responsive and democratic.'* (p. 13)

Figure 2. Financial implications of devolution options



16. Scottish Government (2014) *Scottish Draft Budget 2015-16*, October, pp. 17-18. Stamp Duty Land Tax and the Landfill Tax were devolved under the Scotland Act 2012.

Housing and other social security benefits

The Commission opted to recommend that the bulk of social security benefits remain reserved powers. Benefits accounting for around 15% of social security expenditure in Scotland (see Table 5) are recommended for devolution – mostly the bundle of disability and care benefits. Of these the Disability Living Allowance is the largest in terms of expenditure. Universal Credit, the state pension and Pension Credit are recommended to remain reserved.

Although Housing Benefit is not recommended for devolution, the following powers are offered to the Scottish Parliament:

- '… the administrative power to change the frequency of Universal Credit payments… and pay landlords direct for housing costs…' (para. 44)
- '… the power to vary the housing cost elements of Universal Credit, including varying the under-occupancy charge and local housing allowance rates, eligible rent, and deductions for non-dependents…' (para. 45)
- Discretionary Housing Payments which would be fully devolved (para. 49).

Additional expenditure (including administration) would be met in full by Scottish taxpayers.

Comment: The Smith Commission proposals map onto the lower parts of the reverse triangle of reform options (Figure 1). By allowing direct payment of the housing cost element within Universal Credit to social landlords, and top-up payments relating to eligible rent, the proposals allow the Scottish Parliament to reverse some of the recent changes to Housing Benefit, of which the 'bedroom tax' is the most salient. By focussing on such concerns, the proposals appear reactive and backward-looking. They would not permit further redesign of Housing Benefit, even within the constraints of the wider social security system. For example, the rate at which benefit is withdrawn as income rises (the 'taper') remains reserved, as does the assessment of income and savings. It is difficult to conceive of how anything less could have been devolved. Nonetheless, we re-iterate the point made earlier that the ability to fundamentally reform Housing Benefit is contingent on reform of the wider social security system. Thus the devolution of Housing Benefit without the devolution of at least the other means-tested benefits would still not permit its significant reform.

Finance

The Smith Commission envisages that the devolved Scottish budget will bear *'the full costs of policy decisions that reduces revenues or increases expenditure'* (para. 95(2)). In practice this means that such increases in expenditure would be financed from income tax, or expenditure reductions elsewhere. This is the only significant tax to be devolved to any extent: it is envisaged that the Scottish Parliament will have the power to set the rates and thresholds at which these are paid (for non-savings and non-dividend income only) (para. 76). The personal allowance and tax reliefs would remain reserved (para. 77). Revenues would be assigned to the Scottish Government and the block grant reduced accordingly (para 78). Otherwise, there would be a partial assignment of VAT revenues (para. 84), whilst National Insurance Contributions (NICs) (para. 80) and Corporation Tax (para. 82) would remain reserved. The Scottish Government would also be given borrowing powers to deal with the economic cycle and to facilitate investment in infrastructure (para. 95(5)). This power is not clearly specified, but would remain within the UK's fiscal framework.

Comment: The tax base from which additional expenditure could be financed is conceived to be rather narrow: virtually all variation in expenditure must fall on little more than one-quarter of the tax base. Moreover, there would be no compensation should the Scottish income tax base grow more slowly than in the rest of the UK, or liability should it grow more quickly. Whilst it is legally impossible to vary VAT within an EU Member State, it is possible to envisage NICs (which account for one-fifth of the Scottish tax base) being devolved as part of a wider devolution of social security. The visibility of income tax is likely to mean that Scottish Governments may be reluctant to exercise this power – the failure to use existing very limited income tax varying powers providing a vital clue. Our assessment is that Scottish Governments will certainly use the powers envisaged in Smith to 'abolish' the 'bedroom tax' in Scotland, and probably not much more. Further expenditure is likely to rely on widening the tax base, for example through reformed or Council Tax, or a successor property tax.

Conclusions

In this chapter we have outlined the principal options for the transfer of powers over social security from the UK to the Scottish Government. These range from relatively minor changes to the administration of Housing Benefit to the full devolution of social security. We have also emphasised that devolution must be matched by the ability to fund the responsibilities gained from a diverse tax base.

The Smith Commission proposals on the devolution of Housing Benefit are essentially confined to the ability to alter eligible rents and pay landlords directly. These would allow for the bedroom tax to be abolished and other cuts to be reversed, provided the Scottish Government was willing to fund them from essentially the only variable source of revenue that would be devolved, namely income tax.

Given that meaningful reform of Housing Benefit is contingent on the reform of the wider social security system, and would require balancing control over a suitable tax base, the Smith Commission proposals can be interpreted only as being very limited.

In the final concluding chapter we outline an alternative vision for the devolution of Housing Benefit.

5. Conclusion and Recommendations

Introduction

The national Housing Benefit system has been a part of housing policy for more than 40 years. In that period it has moved from the fringes of housing policy to become the dominant financial subsidy to housing. It has facilitated the shift of subsidies from the supply-side to the demand-side, and has allowed social and private rents to rise whilst protecting the poorest tenants. By facilitating higher rents, it has also played an important role in widening access to private finance for housing associations.

However, these achievements have come at a price. It has created high levels of benefits dependency, removed market signals from many tenants' housing decisions, and created a substantial disincentive to seek employment. Even the vital safety net function that the current structure of Housing Benefit is designed to fulfil has been increasingly undermined by limitations placed on eligible rents. Governments clearly feel that the costs of Housing Benefit are unsustainable. It is possible, for example, that eligibility will be removed for young people aged under 21 after the next UK election. The benefit is also set to be merged into Universal Credit. Whilst tenants will benefit from the simplicity of the new system, assistance with housing costs is likely to diminish over time, as the eligible rent for private tenants becomes increasingly divorced from actual rents. Meanwhile, work incentives are not radically improved.

In the previous chapter, we outlined a hierarchy of reform options in terms of the devolution of Housing Benefit and wider social security benefits, ranging from the status quo to the full devolution of Housing Benefit. We emphasised that the more extensive the devolution of social security, the more extensive the devolution of taxation (including assigned revenues) would be required in order to maintain sustainability and accountability.

We also examined the proposals contained in the Smith Commission report and found them to be very limited and largely based on expediency. What flexibility that has been granted must be financed from a very narrow tax base.

In this chapter we outline alternative proposals for devolution. These proposals are founded on a key principle: if we are to have greater devolution, it must be devolution with a purpose.

Reforming housing in Scotland

The Scottish housing system faces many challenges.[17] House prices are eight times higher than annual incomes, contributing to a shift away from home-ownership to private renting, where people face market rents and insecurity. A decade ago, half of under 35 year olds were owner-occupiers, whilst barely more than one-tenth were private tenants. Now private renters form the largest segment of this group. The decline in the social rented sector has stabilised, but within the context of the depressed level of private sector new build, leaving general needs unmet. The population is ageing, with the largest growth over the next quarter of a century expected among the over 75 group. There are forecast to be almost 400,000 more households in Scotland in 2037, and three-quarters of them are likely to live alone. Moreover, there are some 150,000 people on council waiting lists and a further 30,000 on their transfer lists. Whilst the energy efficiency of the housing stock has improved more than a quarter of the population lives in fuel poverty. These changes present challenges about the numbers, sizes and quality of the housing stock that we need.

The current structure of housing policy is unfit to meet these challenges, because around 80 per cent of subsidies are devoted to limiting the impact of housing (but not energy) costs. This leaves very little to focus on increasing investment in new social rented housing, in improving the quality of energy inefficient and otherwise sub-standard stock in the private and social sectors, or improving the accessibility or adaptability of dwellings to meet the needs of an ageing population. Scottish housing is trapped in a cycle that implies declining access to social rented housing, diminished access to owner-occupation and increased reliance on private renting. This is a trend that implies ever increasing reliance on Housing Benefit, which the UK Government deems to be unsustainable. Within these parameters, when Housing Benefit (or the housing element within Universal Credit) can no longer "take the strain", the implication is higher levels of poverty induced by housing costs, more homelessness, and a strengthening of the link between income poverty and housing deprivation. As Housing Benefit is absorbed into Universal Credit, the transparency of future reductions in housing support is likely to be obscured.

Housing in Scotland requires a sustained long term shift in subsidies, away from mitigating the

17. With the exception of waiting and transfer list numbers (Shelter) the figures in this paragraph are taken from the document "Housing Event Themes and Housing and Regeneration Outcomes: Supporting Evidence", Communities Analytical Services Division, Scottish Government, presented at the Scottish Housing Event, 18 November 2014.

consequences of unaffordable rents, towards one that provides explicit support for investment in housing. This implies that Housing Benefit would need to be removed from Universal Credit and devolved to the Scottish Parliament. This would remove the anomaly from Scottish housing policy whereby 'housing policy' is devolved but Housing Benefit is not.[18] Of course subsidy cannot simply be switched from Housing Benefit to investment. The effects of investment on housing and housing related costs are enjoyed at the margin, and the need for Housing Benefit could diminish only gradually. This implies that either the Scottish Government would need to find the resources for investment from other areas of expenditure, higher taxes or borrowing. As an investment and a social return, the case for borrowing is much stronger than in the provision of other less productivity-enhancing services. A long-term business model could identify the time over which benefits, including the long-term limitation of Housing Benefit expenditure, would accrue. Such a business model would make little sense if the long-term benefits of limiting Housing Benefit spending were to accrue to the UK, rather than the Scottish, Government.

A shift from demand to supply subsidies could be achieved without changing the structure of Housing Benefit. However, no one can be satisfied with the current structure of Housing Benefit. It is a benefit whose sole merit of providing a financial safety net has been undermined by limitations on the eligible rent. The last UK Government recognised the defects in the design of Housing Benefit, and attempted to introduce 'shopping incentives' by introducing the Local Housing Allowance (LHA) in 2006. This was a minor reform affecting private tenants. Plans to extend it to the social sector were never enacted, and even before it lost office, the outgoing Government had announced its intention to remove the positive financial incentive for tenants to find cheaper properties.

The LHA failed, not only because of the demands of austerity, but because Housing Benefit is the prisoner of the wider social security system. So long as mainstream social security benefits make no allowance for housing costs, a residual system such as Housing Benefit will be needed. And so long as such pressure is placed on housing costs by limitations on supply-side subsidies, the more difficult it will be to restore some of the wider affordability functions that were a characteristic of Housing Benefit when it was first introduced, but which were lost in 1988.

Reform of Housing Benefit is therefore dependent both on moderating the upward pressure on housing costs, and on reforming the wider social security system. Over time, **it is desirable for an allowance for housing costs to be introduced into mainstream social security benefits**. This would allow the key features of Housing Benefit that are seen to be undesirable to be reformed. It would no longer be important for Housing Benefit to meet the whole of a tenant's rent; and it would no longer be necessary to increase Housing Benefit by £1 for every additional £1 of rent in order to protect residual incomes. **The Scottish Housing Benefit system could then be reformed to resemble the 'gap' systems that are commonly employed elsewhere in North West Europe and Scandinavia**. This implies that at least the means-tested elements of social security are devolved, alongside Housing Benefit.

Clearly the further devolution of the national insurance benefits would permit more radical benefits reform, but as yet we have seen no template to suggest the purpose of such a move.

Getting from here to there

The transition from a situation whereby social security, including Housing Benefit, is the responsibility of the Westminster Government, to one whereby the Scottish Government can shape policy strategically is likely to be complex. Academic policy analysts refer to the difficulty in changing the direction of policy as 'path dependency.' However, the hierarchies of devolution outlined in the last chapter provide the outline of how we get from here to there, whilst emphasising the need to manage the transition carefully.

The first step would be to keep Housing Benefit out of Universal Credit in Scotland, and to retain its administration by Scottish local authorities, protecting both administrative capacity and expertise. If Universal Credit is introduced in Scotland, then it would be necessary to redesign Housing Benefit in order to prevent Scottish tenants from being disadvantaged by the application of two sets of tapers.

The second step is to ensure that the Scottish Government has the financial capacity to manage its responsibility for Housing Benefit and other social security benefits. This means matching devolution of taxation powers and budgetary responsibility, including the borrowing facilities required to allow for strategic investment in both economic and social infrastructure and the ability to manage expenditure over the economic cycle. We are somewhat concerned by the emphasis placed on income tax in the Smith Commission, and would emphasise the desirability of a tax base drawn from a range of taxes. For those that cannot be devolved legally, revenues attributable to them from Scotland should be assigned to the Scottish budget. It would also be prudent for the Scottish Government to extend its tax base where it has powers to do so, notably

18. Nonetheless, monetary policy and the regulation of mortgage markets would remain reserved.

through the reform of Council Tax or its replacement with a form of progressive property tax. A small open economy such as Scotland needs to be especially wary about taxing mobile, economically productive parts of the economy, and would be wise to focus more on unproductive and immobile factors of production such as land and property.

With these stepping stones in place, it would be possible to embark on a programme of investment in housing supported by government borrowing, and perhaps a widened tax base that exploited to a much greater extent the value of land and property. This programme would require careful preparation concerning the balance of needs between new build, renovation and adaptations, and the most appropriate vehicles for their delivery. **Indeed it should be preceded by a comprehensive assessment of current and future housing needs in Scotland**.

A parallel process of social security reform is likely to be a longer term enterprise. A number of submissions to the Smith Commission have emphasised the care which must be taken when undertaking social security reform. The benefits system has grown up over decades, fulfils many objectives and has complex inter-actions with other benefits and policies. It is these interactions that strengthen the case for wholesale devolution of at least the means-tested benefits, rather than attempting to devolve Housing Benefit by itself. But the duty of care to the most vulnerable must always be placed above impulsive reforms, no matter how symbolic.

Therefore it would be desirable that reform of the housing cost element of the social security system be seen not only as part of a sector-wide reform of housing, but as part of a wider review of income maintenance and support. Parallel debates over, for example, whether subsidies for child care or personal independence should be based on individuals or the direct provision of services will take place. The links between social security, skills and employment would also need to be considered in the round.

Conclusions

The devolution of Housing Benefit, accompanied by the devolution at least of means-tested benefits and balanced with the necessary budgetary powers to manage these responsibilities provides the basis for the reforms needed in order to meet the housing needs of the future.

We must recognise that resources will always be scarce, and it is important to recognise the limitations even of well-considered and executed reform. Housing and social security reform can form just one part of a strategy to tackle poverty that must extend at least into education, training and the labour market. Nonetheless, housing and income maintenance can provide direct benefits to people who receive them. They can provide security and contribute to health. They can facilitate family life, personal independence and employment. Consequently they can furnish devolution with abundant purpose.

Summary of recommendations

- Housing subsidies should be, over time, shifted away from the demand-side and towards the promotion of investment in new and existing housing (while protecting losers in the transition).
- A housing element should be incorporated into mainstream means-tested benefits, and gradually increased.
- Housing Benefit should be redesigned in order to give people more choice and responsibility over their housing.
- Means-tested benefits, including Housing Benefit, should be devolved, subject to sustainable financial arrangements.
- The Scottish Parliament should be given control over a range of taxes, or assigned revenues from them where they cannot legally be devolved, together with sufficient borrowing powers to ensure that these wider powers are sustainable and that the Scottish Government and Parliament are accountable for their decisions.
- As a consequence of the complementary review into Council Tax, the Scottish Government should use its powers to extend the use of its tax base in land and property.
- In the short-run, Housing Benefit should be excluded from Universal Credit in Scotland.

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Appendix A

Universal Credit per calendar month example (based on 2014-2015 rates)

'Work Allowance' – **disregards** per calendar month (Note distinction between those who have Housing Costs and those who do not.)

Universal Credit claimant	Monthly Work Allowance where Housing Costs	Monthly Work Allowance where no Housing Costs
Single no children	£111	£111
Couple no children	£111	£111
Couple with children	£222	£536
Lone Parent	£263	£734
Person with 'limited capability for work'	£192	£647

Example 1:

Universal Credit for a couple (1 or both 25+) with no children with net earnings of £450.00 pcm and who have an eligible rent of £300 pcm.

Universal Credit standard rate (pcm)		£493.95
Eligible rent	+	£300.00
Maximum Universal Credit	=	£793.95
Earnings (NET)		£450.00
Work Allowance (disregarded)	-	£111.00
	=	£339.00
65%	=	£220.35
Universal Credit Payable		£793.95
	-	£220.35
	=	**£573.60** Universal Credit payable pcm

Work Allowance deducted from net earnings and then 65% of this total deducted from the maximum Universal Credit total.

Example 2:

Universal Credit for a couple (1 or both 25+) with 1 child with net earnings of £750.00 pcm. (Separate Housing Benefit claim for eligible rent of £300.00 pcm).

Universal Credit standard rate (pcm)		£493.95
Child Rate	+	£274.00
Maximum Universal Credit	=	£768.53
Earnings (NET)		£750.00
Work Allowance (disregarded)	-	£536.00
	=	£214.00
65%	=	£139.10
Universal Credit Payable		£768.53
	-	£139.10
	=	**£629.43** Universal Credit payable pcm

Monthly Total Income = £1379.43

Separate Housing Benefit Claim weekly calculation

Personal Allowances:			
Couple			£113.70
Dependent child			£66.33
Family (premium)			£17.45
Total		=	£197.48
Income:			
Income from Universal Credit			£145.25
Earnings (NET)			£173.07
Income disregard		-	£10.00
		=	£163.07
Total Income		**=**	**£308.32**
		-	£197.48
		=	£110.84 excess income
	65%	=	£72.04
Housing Benefit payable:			
Weekly Eligible Rent		=	£69.23
		-	£72.04 (65% of excess income)
		=	£0.00 Housing Benefit payable

Total monthly income remains = £1379.43. This calculation assume Universal Credit would be assessed as income, but has been generous in allocating x2 earnings disregards. Note: if Universal Credit not assessed as income for Housing Benefit – full Housing Benefit would we awarded. If rents were higher e.g. £400.00pcm (£92.30 weekly) – Housing Benefit of £20.26 weekly would be payable giving a new total income of £1467.22.

Example 3

Universal Credit for a couple (1 or both 25+) with 1 child with net earnings of £750.00 pcm with an eligible rent of £300.00 pcm).

Universal Credit standard rate (pcm)			£493.95
Child Rate		+	£274.58
Eligible rent		+	£300.00
Maximum Universal Credit		=	£1068.53
Earnings (NET)			£750.00
Work Allowance (disregarded)		-	£222.00
		=	£528.00
	65%	=	£343.20
Universal Credit Payable			£1068.53
		-	£343.20
		=	**£725.33** Universal Credit payable pcm

Total income = £1475.33pcm which is 7% higher (£95.90pcm higher) than if claiming eligible rent separately through Housing Benefit. Although this decreases to a negligible 0.50% if rents were at £400pcm.

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Shelter Scotland
Scotiabank House
6 South Charlotte Street
Edinburgh
EH2 4AW

0300 330 1234
shelterscotland.org

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