

Office of the
Deputy Prime Minister
Creating sustainable communities

Evaluation of English Housing Policy 1975-2000

Theme 2:
Finance and Affordability

housing



Office of the
Deputy Prime Minister
Creating sustainable communities

Evaluation of English Housing Policy 1975-2000

Theme 2: Finance and Affordability

Christine Whitehead
University of Cambridge and London School of Economics

Kenneth Gibb
University of Glasgow

Mark Stephens
University of York

January 2005

Office of the Deputy Prime Minister: London

The findings and recommendations in this report are those of the consultant authors and do not necessarily represent the views or proposed policies of the Office of the Deputy Prime Minister.

The Office of the Deputy Prime Minister
Eland House
Bressenden Place
London SW1E 5DU
Telephone 020 7944 4400
Web site www.odpm.gov.uk

© Queen's Printer and Controller of Her Majesty's Stationery Office, 2005.

Copyright in the typographical arrangement rests with the Crown.

This publication, excluding logos, may be reproduced free of charge in any format or medium for research, private study or for internal circulation within an organisation. This is subject to it being reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the publication specified.

For any other use of this material, please write to HMSO Licensing, St Clements House, 2-16 Colegate, Norwich NR3 1BQ. Fax: 01603 723000 or e-mail: licensing@hmso.gov.uk

Further copies of this guidance are available from:

ODPM Publications
PO Box 236
Wetherby
West Yorkshire
LS23 7NB
Tel: 0870 1226 236
Fax: 0870 1226 237
Email: odpm@twoten.press.net

This document is also available on the ODPM website.

Published by the Office of the Deputy Prime Minister. Printed in the UK, on material containing 75% post-consumer waste and 25% ECF pulp.

January 2005

Product code: 04HC02706/2

CONTENTS

	Page
SUMMARY	5
1. INTRODUCTION	9
2. THE POLICIES	11
3. TAXATION AND REGULATION IN THE PRIVATE SECTOR	15
4. SOCIAL HOUSING SUPPLY SUBSIDIES AND LSVT	34
5. HOUSING BENEFIT	45
6. SAFETY NETS FOR OWNER OCCUPIERS	58
7. OVERVIEW AND CONCLUSIONS	62
REFERENCES	70

Summary

Objectives

- The objectives of policies addressing finance and affordability are to support the required levels of new output and investment in the existing stock and to ensure that households are able to obtain reasonable housing at a price within their means.

- These objectives are affected as much by the macro economic environment and by broader government policies of taxation, subsidy and regulation as they are by specific housing polices.

The Policies

- The main policy areas related to housing finance and affordability are (i) the taxation and regulation of private sector housing; (ii) supply subsidies and the associated regulatory framework in the social sector; (iii) demand subsidies to assist individuals' housing costs and (iv) the provision of safety nets to address problems of inadequate income and risk.

(i) The Private Sector

- The most important policies affecting the private sector have been (a) the reduction and finally the removal of mortgage tax relief together with changes in local property taxation and in transactions costs through stamp duty; (b) the deregulation of the housing and more general finance markets; and (c) the deregulation of the private rented sector.

- Mortgage tax relief, after false starts in the 1970s and 1980s was successfully withdrawn during the 1990s. The process was aided greatly by incremental reductions in relief being introduced at a time of falling mortgage rates which meant that few people actually had to increase payments. Changes in property taxation and stamp duty have been more about broader objectives than about housing: the first was a response to problems of revaluation and has resulted in a regressive system in house price terms (although less regressive than earlier systems); the second has been more about revenue raising than improving the efficiency of the market. Overall these changes have had limited impact on affordability and little measured effect on investment.

- Deregulation of the finance market has enabled many additional households to gain access to owner-occupation; others to increase their investment in housing; and still others to withdraw housing equity for other uses. The impact has mainly been positive and indeed affordability has improved for the majority of owner-occupiers because of the benign macro environment. However there have been real costs for some households who are now more exposed to risk especially during periods of increasing interest rates and unemployment.

- The deregulation of the private rented sector had helped to expand the easy access element of the sector by at least 50%. At the same time the sector has taken on a larger role in housing lower income households. Again the impact has in the main been beneficial, although there is clear evidence that particular groups of households face very high costs in relation to income.

(ii) The Social Sector

- The two main policies here have been (a) the shift from revenue subsidies to local authorities to far lower levels of capital subsidies to the independent social sector and (b) the transfer of large parts of the local authority stock to housing associations (the Right to Buy and other assistance to home ownership is covered in Theme 4, 'Choice').

- The development of the capital subsidy framework for housing associations enabled far greater control over both total subsidy and its allocation between organisations and areas. It also made it possible to introduce a competitive element into these allocations and so increase the incentive to reduce costs. Most importantly it brought private finance and private constraints into the social system.

- The process undoubtedly involved higher rents and, given the increased emphasis on housing the poorest, worsened affordability – although these impacts were mainly offset by Housing Benefit. Most importantly however the much lower levels of subsidy available, and the volatility in that subsidy, restricted social sector output and, together with the constraining regulatory environment facing local authorities which reduced the output nearly to zero, helped keep social output levels to perhaps 50% of identified needs in the 1990s (see also Theme 1, 'Access, Need and Supply').

- The LSVT programme enabled the equity embedded in the existing social sector stock to be realised and supported the introduction of private finance. This has assisted investment in the existing stock, increased incentive to efficient management and been associated with higher satisfaction levels among tenants. Later developments, outside the period of analysis, have allowed some of these benefits to be realised without ownership transfer.

- Overall there are clear shifts away from supply subsidies. These have reduced output and increased rents. The structure of the remaining supply subsidies have also helped to provide greater incentives to efficiency and business planning, the benefits of which are, in the main, still to be realised. The most important problem remains the continued dependence of the social sector on central government funding and the potential volatility of that funding.

(iii) Housing Benefit

- The existence of housing benefit and its structure, by which many of the poorest households face zero housing costs, has helped support many of the changes in subsidy, regulation and ownership in both the social and private rented sectors. In particular it has enabled large-scale reductions in supply subsidies and deregulation of private rents.

- In the main Housing Benefit has been adequate to ensure affordability in the social sector, although those just above eligibility levels may pay high proportions of income. Over the last decade it has become markedly less successful in the private rented sector as the result of restrictions which have been introduced to control rising public expenditure costs but which can mean that even those in receipt of benefit pay high rents in relation to income.

- A particularly valuable attribute of the housing benefit system is its capacity to address the effect of unexpected changes in employment and income. Many commentators see the lack of an equivalent benefit for owner-occupiers as contributing to housing problems relating to macro-economic volatility and political risk.

- The housing benefit system is seen to have many inefficiencies and inappropriate incentives. However the evidence that behaviour patterns of recipients are significantly modified is limited. Moreover while fraud and other administrative problems are evident, the cost of administration and the capacity to keep social security payments relatively low may well outweigh these costs.

(iv) Safety Nets to Owner Occupiers

- The state safety net for low income home owners (Income Support for Mortgage Interest – ISMI) has been increasingly restricted over the period. To a significant extent the government has seen privately provided mortgage payment protection insurance (MPPI) as a replacement, although not for the most vulnerable households and for long term loss of income.

- The introduction of MPPI was encouraged by government following the mortgage arrears and possessions crisis of the early 1990s but has only partially addressed this issue. In particular, those who are on tight budgets and who do not generally insure against the risks they face are unlikely to take it up. Coverage and eligibility are also restricted.

- The evidence suggests that ISMI falls short of what is required to ensure affordability in the face of unexpected problems. Equally while the coverage of MPPI is expanding, it is not clear that those incurring the highest risks are adequately covered, especially in the face of recession and/or increasing interest rates.

Overview

- Policies with respect to finance and affordability in the 1970s mainly addressed issues associated with rapidly rising inflation and macro-economic instability. By the 1980s the emphasis moved very much to privatisation and deregulation, together with reductions in public expenditure and pressures towards real increases in rents and interest payments. In the 1990s the benign economic environment meant that affordability improved for the majority of owner-occupiers while housing benefits continued to support tenants on low incomes, particularly in the social sector.

- Large scale shifts in subsidy and reduced regulation were in general effected without major problems of affordability, except for an important minority of private sector tenants and tenants whose incomes are just above eligibility for housing benefit. Finance and insurance markets have been developed – while costs to government have been significantly reduced.

- Many of the changes in policy were more a response to external pressures than pro-active attempts to achieve specific housing goals. The system has failed to provide adequate incentives or financial support to maintain output particularly in the social sector. This in turn has been partially to blame for increasing problems of access to both owner-occupation and social housing especially in pressure areas.

- Finally during the last few years the system has not been subject to the stresses associated with either recession or inflation. Both would almost certainly result in large-scale problems of affordability and investment. The process of incremental change in response to external pressures which epitomises housing policy since 1975 does not appear to have built a robust system that can achieve both adequate investment and affordability over the economic cycle.

1. Introduction

1.1 The government's fundamental housing objective in the context of finance and affordability is to ensure 'a price within their means' within the overall objective of a decent home for every household together with reasonable choice of accommodation.

1.2 In the wider context of overall government objectives, the question must also include how housing is prioritised in relation to other public expenditure decisions and its position in legislative, and particularly regulatory, change.

1.3 Evaluation of affordability and finance policy should therefore, to be reasonably comprehensive, assess the effectiveness of public expenditure allocations in achieving appropriate investment and pricing decisions across tenures and how housing relates to broader taxation and distributional objectives.

1.4 Finance and affordability objectives and outcomes are particularly affected by broader economy-wide themes including:

- reducing public expenditure for both macro stability and structural reasons;
- deregulation and liberalisation in order to increase competitiveness, wider choice for consumers and better value for money;
- privatisation – another element in supporting efficient production and choice, strongly linked with asset restructuring aimed at improving the use of available resources and at reducing the government expenditure necessary to meet more fundamental objectives;
- risk reduction and better allocation of remaining risk in the context of deregulated markets and the restructuring of and reduction in public sector expenditure and safety nets; and
- ensuring that housing outcomes are sustainable in the face of longer term changes in the macro-economy and consumer aspirations.

1.5 Finance and affordability outcomes must also be assessed in the context of broader distributional objectives, including in particular the effective targeting of assistance to achieve adequate housing but also more general issues of whether, at the bottom end of the distribution, people have the capacity to buy the full range of other necessities and more broadly whether the resultant overall distribution of income and wealth is appropriate (Whitehead, 1991; Hancock, 1993).

1.6 In evaluating the policies which make up this theme it is therefore not enough to look simply at the prices or rents that people pay for their housing. It is also necessary to assess the impact of financing regimes on investment in net additional output; the maintenance and improvement of the existing stock; the relationship between rents/prices/user costs and household incomes; resultant tenure changes and the impact of changing tenure structure on individual affordability; and, an emerging theme over the period, related in particular to privatisation and liberalisation, the risks that households and institutions face in maintaining consumption, output and affordability.

1.7 The finance and affordability theme inherently links directly to the other themes of the research. It affects access both to housing of any kind and to particular types of housing in terms of size, quality and tenure. Affordability is irrelevant if people are excluded from being able to spend on the housing they require. It equally strongly modifies choice, as the extent of constraint in housing choice may impact both positively and negatively on actual housing expenditure (for instance through the differential costs associated with tenure change). It relates to the question of the quality of housing , where a particular problem is that measures of affordability tend simply to estimate cost in relation to income rather than asking what is obtained or whether the outcome is equitable. Finally, and, in the context of government expenditure perhaps most importantly, it links to the question of the efficient use of public resources in achieving housing goals.

1.8 Thus the objective of this report is to assess impacts and outcomes in housing terms – did each policy achieve its stated aim and at what cost and did the set of policies improve outcomes with respect to both public expenditure and affordability? However as compared to other themes it must be remembered that objectives may be more broadly defined e.g. to reduce resources going to housing as compared to other government priorities; to allocate resource costs and risks more directly to those who benefit from the service; to increase efficiency and sustainability among housing institutions; and to protect those least able to help themselves. Equally the economic environment, and particularly national income, has changed very significantly over the period under discussion. The relative importance of housing must therefore be expected to change – for instance on some statistics, people now, on average, spend more on leisure than housing. How change is evaluated must necessarily take these factors into account. Finally, the starting point in 1975 was certainly heavily distorted so, simply showing that housing costs, or indeed risks, have increased would not of itself imply that policy had failed. Just as importantly, what is acceptable now in terms of government priorities is very different from what would have been acceptable in 1975.

1.9 This assessment therefore deals with three main themes: the effectiveness in their own terms of changing housing policies (i.e. did the policy have the outcome expected); the impact of these changes on housing affordability across the income scale and particularly at the bottom end of the market; and the outcome on the overall housing system and its relationship to the broader economy.

2. The Policies

2.1 The policies included in the theme can be grouped under three main headings:

(i) the taxation and regulation of private sector housing;

(ii) supply subsidies and their associated regulatory framework in the social sector; and

(iii) demand subsidies, including their scope and their relationship to broader taxation and subsidy issues.

2.2 A fourth area (iv), that of safety nets, relates both to (i) in the context of developing appropriate insurance products and to (iii) through the relationship between social security and housing expenditures.

2.3 Policies under (i) *taxation and regulation of the private sector* include a wide range of different types of specific interventions both with respect to taxation of housing and related issues and to deregulation. Most important among these are:

- the modification and ultimate removal of mortgage tax relief;
- the staged deregulation of the housing finance system; and
- the deregulation of the private rented sector.

2.4 In the tax context there have also been significant changes to capital gains taxation, to VAT, to property taxation, to the taxation of transactions through stamp duty, and to the tax treatment of landlords in different contexts.

2.5 In addition, there have been short-lived attempts to provide tax benefits to landlords under the 1980 Act in the form of accelerated depreciation and the Business Expansion Scheme. The introduction of tax benefits to development in regeneration areas currently being introduced lies outside the period of evaluation but points the way to possible future initiatives.

2.6 Policies under (ii) *supply subsidies and regulation* concentrate on:

- the changing revenue financing framework related to local authority housing;
- the evolving capital based financing system underpinning new investment and renewal in the housing association sector; and
- policies aiming to restructure social sector housing finance and institutions particularly through large-scale voluntary transfers.

2.7 The vast majority of these policies relate to social housing. In addition there are supply side policies to assist owner-occupation as well as large scale subsidies to transfer under the Right to Buy. These are mainly being addressed under theme 4, choice.

2.8 These core financial policies were supported by large-scale changes in the regulatory and legislative frameworks in which local authorities and housing associations operate. A particularly important element in the regulatory framework has been changes in the rent determination regime in both sectors and their effect on both affordability and financing – as well as on the incentives to transfer stock between sectors.

2.9 The most important *demand side* policy (iii) is housing benefit. The fundamentals of this policy have not changed significantly over the period although their coverage and impact have been subject to almost continual modification. Housing benefit, and its earlier manifestations of rent rebates and rent allowances have been the only important housing specific policy assisting tenants at the bottom end of the scale.

2.10 What has changed has not been the policy but the economic environment linked with coverage, together with the rent regimes introduced in the different sectors and modifications to allocation rules. As a result housing benefit has become a far more important element in determining affordability in the rental sector than it was in 1975, while at the same time modifications in the regulatory framework have limited choice and differentially affected particular groups, notably younger households and refugees and asylum seekers.

2.11 This is also the area where a notable potential policy has not been introduced – that of benefits to owner-occupiers.

2.12 The more fundamental changes have been associated with the general welfare system of which housing benefit is an important part. The introduction of working family tax credits, and now pensioner credits, has had as much or more impact on affordability as changes in housing benefit itself.

2.13 The question of *safety nets* (iv) is closely linked to the changes in the more general social security system with respect to the costs of mortgages. Reductions in ISMI (income support for mortgage interest) and the introduction of MPPI (mortgage payment protection insurance) in the early 1990s are probably the most important policies during the period. Again the regulatory framework notably with respect to financial services, and the impact of the wider economic environment in the context of MI (mortgage indemnity insurance) and MPPI have been of equivalent importance.

2.14 The methodology employed in the theme papers was to specify Beacon policies for particularly detailed analysis which form the core of policy change. For finance these were:

- in the private sector, the deregulation of the private rented sector;
- in the social sector, capital subsidies to RSLs; and
- with respect to demand subsidies, housing benefit.

2.15 Other policies, such as mortgage tax relief, finance market deregulation and changes in the subsidy framework for local authorities have been just as important in determining outcomes over the twenty-five year period covered by this assessment. However these can be regarded as having run their course and so are not regarded as Beacons for the future.

2.16 Still other policies although important in terms of both understanding and specific impacts are not so core to the overall assessment and are discussed in less detail. Pro-formas are available for all policies.

2.17 The typology set out above relates directly to the existing structures of housing finance. However it is clear that the policies could be grouped in many different ways, some of which would help our understanding of how different elements interact to generate particular outcomes. They could be grouped under:

(a) policies to assist the development of markets – notably with respect to the broader liberalisation of finance markets – insurance, mortgage products and mechanisms such as securitisation.

(b) modifications of specific regulatory frameworks. This relates to the deregulation of building societies and other housing finance institutions in the early 1980s; to the changing powers of local authorities and RSLs again notably with respect to financing in 1988; and also to rent restructuring and allocation policies and to the deregulation of the private rented sector;

(c) taxation and subsidy policies and their impact on price (including rents and user costs), output and allocation; and

(d) direct provision through both local authorities and independent social landlords.

2.18 This typology helps to clarify a number of important themes that have dominated the period under discussion (Whitehead, 1994), notably:

- the importance of market building and addressing the consequences of privatisation, where past public provision has meant that institutions and instruments were inadequate;

- the declining role of direct provision and its partial replacement by the regulation and subsidisation of independent bodies for whom incentive structures are of greater importance;

- the shift from supply subsidies to demand subsidies with its implications for targeting and differential impacts on affordability across tenures and income groups;

- the extent to which deregulation and liberalisation has been concentrated in the private sector while in the social sector the emphasis has, if anything, been on additional regulation; and, finally,

- the extent to which the objectives of reducing both direct expenditures on housing and bringing taxation more into line with general principles reflect both the broader objectives of government policy and the relatively benign environment in which much of that policy has been implemented.

2.19 These themes should be borne in mind when assessing both particular policies and overall outcomes.

2.20 In the following sections, each of the four main areas set out at the beginning of this section are evaluated in terms of policy, impact and outcome with respect to finance and affordability, starting with the private sector. Section 7 attempts an overview, followed by conclusions.

3. Taxation and Regulation in the Private Sector

Introduction

3.1 With respect to the private sector the period has been one of market building, deregulation, liberalisation and limitations on government expenditure. Finance specific policies have been led by conditions in the wider economy, both positive and negative, and have been framed by these wider tensions. As a result of policy change housing finance is far more integrated into the broader economic system. A second objective has been to transfer significant proportions of housing funding from the public to the private sector and in the process to improve pricing and risk allocation. Affordability objectives have not been central to policy development. Rather the aim has been to maintain reasonable affordability in the face of the desired changes in finance. Success in all contexts has been dependent on the broader efficiency of the finance system and on moving with the grain of the macro-economy.

3.2 The main changes can be grouped under three main headings: (a) housing tax changes, impacting mainly on owner-occupation; (b) liberalisation of the housing finance market, and (c) deregulation of the private rented sector.

(a) Housing Taxation Changes

Mortgage Tax Relief

3.3 The most important financing policy in this context was the reduction and ultimate elimination of mortgage tax relief (Pro-forma 3.1). It was clearly recognised at the time of the Housing Policy Review (Department of Environment, 1977) that the owner-occupied sector was disproportionately privileged in tax terms, especially in an environment of rapid inflation and often negative real interest rates. The common understanding was that owner-occupiers benefited from the lack of capital gain taxation on the principal home (when other assets were taxed on money gains) and the lack of imputed income tax, while receiving tax relief on their mortgage interest costs. Owner-occupiers able to access the special circuit of housing finance, and especially existing owner-occupiers, therefore gained heavily at the expense of those excluded from being able to purchase. Most of the benefit was seen to be capitalised into house prices (although quantitative measures of this impact were lacking) (Buckley & Ermisch, 1982, Hughes, 1987). There was therefore a strong incentive for government to modify the tax framework, not least because of the loss of revenue. There were also overwhelming difficulties in implementing change, notably because of the impact of inflation on the tax burden borne by middle income households and the general acceptance of mortgage tax relief as a reasonable benefit.

3.4 The approach taken was not that suggested by many analysts which was to treat housing as an investment good and therefore to tax imputed incomes and allow mortgage costs against that income (Department of Environment, 1977; Grey, Hepworth & Odling Smee, 1974; Whitehead 1977). Rather the more politically practicable approach chosen was to treat owner-occupied housing as a consumption good – as suggested by the Inquiry chaired by the Duke of Edinburgh (Best, 1980). Thus the policy became that of chipping away at the formal tax relief whenever economic circumstances made this possible and accepting a slower rate of change when the general economic and political environment was less clement. Inflation, economic growth and ultimately lower interest rates did the rest.

3.5 The first constraint was on the total borrowing against which relief could be claimed. This was set at £25,000 in 1975, which affected only a tiny minority of purchases (Whitehead, 1979). The total was raised to £30,000 in 1983 and at the same time the relief was redefined as a subsidy (MIRAS – mortgage interest relief at source) making it clear what the costs were to the Exchequer and setting the scene for removal. However, it was not until the 1990s that continued income growth, falling interest rates and declining inflation made it possible further to limit the benefits within this framework. Higher rates relief was abolished in 1991; the rate of subsidy was separated from the tax rate in 1994; and the relief was finally abolished in 2001.

3.6 In many ways this was a textbook example of how to implement policy change – in that the ideas were developed but very little policy change was possible in the 1970s because of the economic environment; providing it at source, separating it from the tax rate and identifying it as a subsidy in the 1980s made it easier to implement a policy of restricting eligibility; and a benign environment of declining interest rates in the 1990s made its removal affordable to households.

3.7 A minor, but extremely important glitch in 1988 when an announcement was made about shifting eligibility from individuals to the dwelling was equally a textbook example of how *not* to implement change. The general objective of giving people some certainty about the future was important in managing demand and household budgets. However, on this occasion, giving some months notice of a restriction in an anyway overheated market led to a massive increase in the numbers of households trying to buy. Many of those households could not then sustain their outgoings when the economy turned down, unemployment rose rapidly and for a short period rapid inflation pushed up outgoings.

3.8 An assessment in the late 1990s (Holmans & Whitehead, 1998) showed that, of the 'savings' in expenditure between 1990/91 and 1996/7, two thirds could be associated with lower mortgage rates and one third with the restrictions on eligibility imposed between 1991 and 1996 – by which time the rate was down to only 15% on £30,000. One finding of this and other analyses is that, because of the rapid decline in money interest rates during the 1990s, there was little adverse impact on general owner-occupier affordability. The political impact in particular was negligible and there was no evidence of the policy change causing difficulties to specific groups of households.

Table 3.1: **The Importance of Mortgage Tax Relief**

	House Purchase Interest (Gross £bn)	Tax Relief (£bn)	Tax Relief as a % of Gross Interest (%)
1975	2.5	1.0	38
1985	15.8	4.8	30
1990	39.7	7.7	19
1995	27.9	2.7	9
2000	—	0	0

Source: Holmans and Whitehead (1998)

3.9 Table 3.1 shows how the extent of interest payments and the proportion of tax relief varied over the period from 1975 to 1996 – reflecting, in particular, variations in inflation and increases in the numbers of mortgages.

3.10 The impact on the distribution of benefits and income was also significant. In 1990/91, prior to the main restrictions being imposed, Inland Revenue statistics showed that those on incomes of £40,000 or more were receiving 171% of the overall average relief, while those with incomes of less than £5,000 received only two thirds of the average. The extent of regressivity was reduced significantly over the period because of both the continued restriction to £30,000 and the declining percentage subsidy available until the relief was finally abolished in 2000/2001.

3.11 It is important to recognise that the implementation of this policy change, while paying lip service to the more fundamental debate with respect to tenure neutrality, was in actuality driven as much by the desire to cut public expenditure as to achieve housing objectives. From the point of view of the taxation of housing, the result of the policy is now to treat owner-occupation as a consumption good while continuing to treat private renting as an investment good. This has important implications for the incentives to invest in the fabric of owner-occupied housing as well as for the choice between owning and renting. Thus, while the system has undoubtedly become both less costly and less regressive, there is little evidence of growing coherence in tax policy.

Local Property Taxation

3.12 In addition to the abolition of mortgage tax relief, there have been other relevant tax and subsidy changes, again mostly implemented in order to achieve broader policy and economic goals. Of importance in terms of housing affordability and house prices were changes in local government finance (Pro-forma 3.2). Traditionally the local element of local government finance was funded through rates, which, in principle, were based on the rental value of properties in the area. (In practice the relationship was limited by lack of evidence on market rents, irregular revaluations and extreme regressiveness in relation to capital values). The shift to a Community Charge in 1989 broke the link between housing and local taxation and provided an incentive to increase the demand for housing, because the user cost specific to housing was reduced (Department of Environment, 1988; Hughes, 1987). This occurred at just the time that the 1988

mortgage tax relief restriction, which transferred eligibility for relief from the individual to the dwelling, was introduced in the Budget but implemented six months later. Although the general result was a bubble in transactions and prices, the longer term independent impact of local government taxation change is difficult to distinguish. The shift back in 1991 to a tax based partly on capital values – although with ratios between the average and higher/lower value properties administratively determined – had the opposite effect. The actual impact of a return to taxing 'capital values' appears also to have been relatively small, within the particularly dysfunctional market of that period.

3.13 This is not to dismiss the possibility of significant opposition to property revaluation and perhaps changes in property tax relativities in the next few years as well as a significant impact on demand and prices if the economic environment is less positive when changes in local government taxation are announced.

Stamp Duty

3.14 The other major tax change has been with respect to Stamp Duty (Pro-forma 3.3). Here the form of the tax has hardly changed since it was first introduced in 1694. However the rates at which it has been levied have been modified for a number of reasons ranging from an attempt to stimulate the housing market and helping particular localities, on the one hand, to an attempt to slow down overactive markets, especially in higher priced properties on the other. The most important reason for maintaining Stamp Duty remains its tax raising capacity, which has increased from £830m in 1997/8 to £2.76bn in 2001/2002. A one percent rise in house prices on average yields a 1.6% in tax yield – although this may be somewhat reduced by the latest exemptions (Andrews *et al*, 2003).

3.15 Stamp Duty, and particularly increases in that Duty – affect people's capacity to pay and therefore has some impact on house prices. For existing owner-occupiers it reduces the incentives to move, which could, in turn, adversely affect the operation of the labour market. These linkages are however complex and the data are not adequate effectively to identify independent effects in an anyway rapidly changing market (Andrews *et al*, 2003). Another problem recognised by the Treasury has been that, because it has been levied on each transaction, Stamp Duty could also differentially affect large institutional purchasers in the private rented sector.

3.16 There have been other tax and subsidy changes which have impacted on finance and affordability in the private sector, including changes in VAT (Pro-forma 3.4) and in private improvement grants (Pro-forma 3.5). These have mainly been determined by more general taxation changes and by the desire to reduce public expenditure. VAT in particular has affected choices between new building and improvement/regeneration (Holmans *et al*, 2003) while reductions in assistance to improvement have impacted on the incentive to undertake investment that is often not reflected in price increases (Lomas, 1980).

The Impact of Tax Changes

3.17 Overall, the impact of tax changes has been to reduce public expenditure/reliefs available to owner-occupiers and to increase tax revenues from transactions. Most of these changes have therefore limited demand, reduced the incentive to move and modified the incentive to finance through debt rather than equity. The impact could therefore be expected to be on the rate of growth of owner-occupation; on the level of outgoings faced by those buying with the help of debt finance; on the extent of such borrowing; and on house prices. In all these contexts it is extremely difficult to separate out the impact of tax changes from other factors that were varying at the same time.

3.18 What is clear is that:

- the rate of growth of owner-occupation slowed down in the 1990s both in proportionate and absolute terms (Table E.1). The number of owner-occupied units increased by 2.4 million between 1971 and 1981; 3 million between 1981 and 1991; and only 1.6 million between 1991 and 2001. Excluding the Right to Buy, increases were 1.8 million between 1971 and 1981; 1.9 million between 1981 and 1991; and only 1.1 million between 1991 and 2001. In part this was associated with a decline in the relative tax benefits; although most observers would argue it was as much or more to do with getting close to saturation in terms of sustainable levels of owner-occupation; as well as the greater uncertainties in the economy and particularly in the labour market;

- equally the numbers of transactions have varied with the overall economic, and particularly the housing market, cycle (Table H.1) rather than with changes in tax policy – except in 1988 when transactions were pushed to 1.9 million in part as a result of the announcement of tax changes to be introduced after six months;

- the evidence on affordability also suggests that the major impact was that from increasing incomes and declining interest rates in the 1990s rather than from the removal of reliefs. The average net effect was to improve affordability. On the other hand risks also increased with mortgage possessions reaching their peak, at over 75,000, in 1991 but falling consistently thereafter to 18,300 in 2002 (Table H.2). The house price to earnings ratio (which is not directly affected by mortgage tax relief – but is indirectly affected because people's decisions vary in relation to affordable outgoings and risks) has increased from a low of around 3.0 in the early 1990s to 5.24 in 2002 (CML, Housing Finance, Table 10). However, at the same time the mortgage interest rate has fallen from a high of over 14% in 1989 to 5.34% in 2001 (Table H.2). The net effect is that, although house prices have more than doubled in money terms over the decade, average actual first year mortgage payments are still not as high as they were in the late 1980s, even in money terms;

- thus, while changes in mortgage tax relief increased payments, the impact was relatively unimportant in relation to individuals' budgets because of the ways the changes were introduced and because of improvements in the macro-economic environment. This is not to say that there would have been no affordability problems in the 1990s if restrictions had not been first introduced on total amounts eligible in the 1970s. Limiting assistance meant that the effect on affordability during

the 1990s was inherently relatively small – especially as interest rates were falling. The same type of analysis applies to levels of advances and indeed percentage advances, which have both varied with the economic cycle rather than as a result of taxation change;

- equally there was undoubtedly some effect on house prices as a result of the changes but this was lost in the broader impacts arising from basic economic relationships. Undoubtedly if mortgage tax relief had not been first restricted and then abolished house prices would have been higher and the proportion of owner-occupiers would similarly have been greater. Equally without increases in Stamp Duty there would have been more transactions. However the reality is that the no change option was never feasible, especially in terms of eligibility for mortgage tax relief, because the public expenditure/loss of revenue associated with increasing owner-occupation levels and house prices would not have been sustainable once housing finance markets had been deregulated;

- the overall assessment must therefore be of a policy change reasonably well implemented and which, in the main, has had positive impacts on efficiency, distribution and sustainability.

3.19 General taxation with respect to owner-occupation is currently not much of an issue. However owner-occupied housing is still treated in a very different way from other assets. There are important interrelationships with wealth distribution, inheritance and funding old age, as well as with respect to maintaining the existing stock. These are likely to be of growing importance over the coming decade.

3.20 The other relevant current issue lies in the perceived need for assistance to groups of first-time buyers, notably key workers. Mortgage tax relief was never targeted in this way, even though it helped smaller mortgages disproportionately. It is anyway unlikely to be seen as a suitable approach in the current environment even though there are examples of its use to assist particular groups in other countries (Scanlon & Whitehead, forthcoming). Other types of subsidy, notably those that have assisted entry to owner-occupation – the Right to Buy and Low Cost Homeownership initiatives – are discussed in detail in Theme 4 on choice.

(b) Deregulation of Housing Finance

3.21 The second major policy area with respect to private housing was the deregulation of the special circuit of housing finance, mainly during the 1980s (Pro-forma 3.6). This was part of the much broader agenda of liberalisation and globalisation of finance markets. The housing finance elements were put in place through the removal of the corset on banks, legislation to provide a new framework for building societies, taxation changes and the introduction of new regulatory mechanisms. Housing finance is an important aspect of both Basle 1 and Basle 2 – the agreements by the Committee of Banking Supervisors – where the international regulatory framework is set out, including in particular capital asset ratios by category. These affect both the overall amount of funding that can be made available and the most profitable instruments for the banking industry to use. They are also strongly affected by more general issues of financial services regulation.

3.22 In 1975 the housing finance market was dominated by the building societies, although over the decade before both local authorities and insurance companies had played significant roles in providing respectively for public sector employees and for better-off owner-occupiers (Boleat, 1982; Boleat & Coles, 1987). In particular in the early 1970s local authorities had provided mainly fixed interest mortgages for over 20% of the market but withdrew in the face of public borrowing constraints and losses related to rising interest rates. The building society system operated as a special circuit. Households were normally required to save, to provide for the down-payment and to gain membership of the mutual institution, but usually at relatively low interest rates, in order to be given access to a mortgage, equally often at below market interest rates. Thus lending took place at terms dictated by the building societies to low risk households on low risk property. Those unable to obtain a mortgage either had to borrow at far higher interest rates from the informal sector, or to remain as tenants (Karn *et al*, 1985; Boleat and Coles, 1987).

3.23 During the rapid expansion of the money supply in the early 1970s the availability of funds together with an increased incentive to borrow and buy housing as a hedge against inflation (plus rapid income growth, demographics and other factors) meant that demand for housing far outstripped the still constrained supply resulting in the largest increases in house prices ever experienced in the UK. The Joint Advisory Committee was set up in 1973 to provide guidelines on lending and interest rates aimed at controlling this demand, and particularly its volatility (Whitehead, 1977). Thus in 1975 the system was highly regulated, undoubtedly limited the expansion of owner-occupation and levels of demand among existing owner-occupiers, but provided very large benefits for those able to access funds.

3.24 The process of change was initially quite slow but moved rapidly after 1980. It consisted of modification of the rules governing banks so that it was worthwhile entering the market; followed by changes to the tax framework and, in the Building Societies Act in 1986, to the regulatory framework for building societies to allow them to compete more directly against the banks; and by regulatory change to enable building societies to restructure themselves as banks (Boleat & Coles, 1987). The process was iterative: external factors – i.e. changes in the broader financial regulatory systems led to changes in the housing specific system which were then followed by further consequential changes to address problems which emerged as a result of these earlier changes.

3.25 Fundamental to this process of change was that housing finance moved from a near risk-free market to one where risks needed to be assessed in an often rapidly changing environment. In 1975 the loan to value ratio was relatively low (with insurance for mortgagees in place above 70%); the security of the dwelling was conservatively assessed (it was still difficult to obtain a loan on a flat, for instance); the price/income and repayment/income ratios on which households could borrow did not expose them to particularly heavy risks, even in a rapidly changing economic environment; while mortgage tax relief softened the impact of interest rate change. As a result neither mortgagors nor mortgagees felt it necessary to take much account of potential risks.

3.26 Equally the terms and conditions under which mortgages were on offer could be mainly dictated by the institutions. Local authorities had offered fixed rate mortgages as had some insurance companies. However building societies as retail organisations lent long and borrowed short – so they inherently had to transfer interest rate risk to the borrower through variable rate mortgages. Most mortgages were annuity mortgages – unsuited to periods of rapid inflation because of the front loading problem. As inflation took off in the early 1970s – and marginal tax rates increased for many households, the large scale tax incentives available for endowment mortgages became more important. They also provided useful premium income to insurance companies while presenting little or no risk to building societies as the insurance had to cover the full debt. There was little reason to compete and margins between mortgage and savings rates were high.

Impact of deregulation

3.27 The deregulation of the mortgage market effectively made it possible to expand owner-occupation and to support the Right to Buy without additional government expenditure. This is reflected in the growth in the numbers of owner-occupiers, in the numbers of mortgages and in the scale of mortgage debt. It also generated a competitive environment in which banks across the world could provide funding. This resulted in two main outcomes: first the market was restructured in terms of providers; and second the range of mortgage products increased enormously. With respect to the first the number of building societies dropped from nearly 2000 in the early 1970s to 65 in 2001 while the banks became the majority lenders (partly by demutualization of societies). A secondary market was developed in the later part of the 1980s, which has been able to mature in the late 1990s and early 2000s (Holmans *et al*, 2003). In terms of products the market now provides not only variable rate annuity and endowment products, but also discounted variable rate mortgages and short-term fixed mortgages as well as tracker and capped mortgages (Miles, 2003).

3.28 The initial expectation of deregulation was that it would increase mortgage and savings rates until equilibrium was obtained, thus allowing all those who wished to borrow to do so but at a higher cost. Liberalisation however enabled entry by all institutions able to compete, so that margins (in the end) declined and mortgage rates were almost certainly lower than within the special circuit system. Diamond & Lea (1992) argued in their evaluation in the early 1990s that measured in housing terms the UK system was the most efficient and mature housing finance market in the industrialised world.

3.29 Where there was less analysis was with respect to the effect of changing terms and conditions and the effective evaluation of risk by either mortgagor or mortgagee. During the 1980s inflation and reasonable macroeconomic conditions protected both sides from the changes that had taken place. In the late 1980s a mixture of overheated housing and housing finance markets, followed by sudden increases in interest rates associated with worsening inflation and an equally rapid increase in unemployment, led to major repayment problems and an incapacity for people to sell their way out of trouble (the usual mechanism for addressing problems in the past). The resultant pressures in terms of arrears and possessions put the housing finance market and its associated insurance market under very considerable stress (Boleat, 1994).

3.30 The government's response, which was to advise financial institutions to address their own problems, usually through restructuring mortgage repayments, was successful – a good example of the lack of direct formal intervention. The industry allowed people to go into longer term arrears rather than lose possession. Possessions reached their peak of 75,000, 0.75% of all loans in 1991. while mortgage arrears of over 12 months rose to over 1.5% of all loans in 1993. Their second response was to encourage the development of mortgage payment protection insurance (see Section 6 below).

3.31 Another area of concern was the mis-selling of endowment policies linked with modifications in the tax regime that had made them worthwhile in the 1970s. During the later part of the 1980s surprisingly large numbers of those who took out new mortgages were encouraged to cash in their existing policies and take out new ones – against their own interests. In the late 1990s /early 2000s the problem has been rather different – that declines in stock market returns means that the outstanding mortgage debt may not be fully covered at the end of the term. These problems have reduced confidence in the market and have increased the perceived need for regulation and for the development for long-term fixed mortgages which transfer risk away from the borrower (Miles, 2004).

3.32 Deregulation has also effectively supported the Buy to Let initiative in the private rented sector (although the risks associated with this are yet to be fully assessed) (Rhodes *et al*, 2003). More fundamentally, opening up the wholesale finance market allows better Treasury management within housing finance institutions – as does the potential for diversification in terms of lending by retail providers. These opportunities reduce risk and help to stabilise the flow of funds as well as possibly reducing interest rates.

3.33 Conclusions on the impact of financial deregulation include:

- the impact of the deregulation of finance markets in general and the housing finance market in particular has generally been positive in terms of numbers of households served, extent of competition and the development of the market;

- the direct impact of deregulation was on the numbers of mortgages made available and the types of lenders making those loans. Table 3.2 shows both how the numbers have increased over the early part of the period and how they have varied with the economic cycle. Equally, it reflects the disappearance of local authority and insurance company loans, the decline in importance of building societies and the development of centralised lending associated with securitisation;

- those problems that have arisen appear to have occurred because institutional and regulatory systems have been too inflexible and have not been effectively restructured to address the new conditions, and, most fundamentally, because risks in a rapidly changing economic environment have been inadequately assessed.

Table 3.2: **Number of Mortgage Advances per Year (000s)**

	1975	1980	1985	1990	1995	2000
Building Societies	651	675	1,073	780	513	311
Banks		_	176	333	346	734
Insurance Companies	22	18	19	26	–	–
Local Authorities	101	16	23	8	–	–
Other Specialists						
Lenders	–	–	–	–	50	68
TOTAL	**772**	**709**	**1,291**	**1,147**	**909**	**1,113**

Source: Housing and Construction Statistics; Bank of England

3.34 Other variables by which the impact of deregulation could be assessed relate to (i) the rise in owner-occupation; (ii) the margins available to mortgage institutions; (iii) the choice of products available to potential mortgagors (and savers); and, (iv) changes in affordability, and within this, most importantly, the extent of arrears and possessions.

- It is clear that with respect to (i) that deregulation shifted the market to one where consumers could obtain the funding they wanted at the market price rather than being subject to supplier restrictions. It is also clear that a large proportion of the rapid rise in owner-occupation in the 1980s was associated with easier finance. Kleinman & Whitehead (1988), for instance, estimated that about one third of the increase in the 1980s could be associated with deregulation, a further third with the Right to Buy, and the rest with income growth. The fear has been that this has allowed both institutions and mortgagors to take on risks which they have inadequately understood. This was reflected in the late 1980s in very high loan to value ratios (over 125% for many first-time buyers) as well as high loan to income ratios. In the early 2000s average loan to value ratios were around 66% on average although there is again evidence of very high leverage at the margin (arguably backed by current income, (Nuttall, 2004)). Equally although loan to income ratios have risen rapidly over the last few years, actual repayments have not. In the current benign economic environment, affordability appears to be reasonably under control. This is not to say that were the environment to change, notably with respect to the capacity to sell if an individual runs into difficulties, some of the problems associated with the late 1970s would not re-emerge.

- Evidence on (ii), margins, suggests that new business is being conducted at current opportunity cost so that competition is providing reasonable value to consumers. It is only the existence of back books which tends to suggest excess profitability still remains among established lenders (Holmans *et al*, 2003; Miles, 2003).

- On (iii), evidence from the Family Expenditure Survey suggests that the proportion of homebuying households with endowment policies has fallen from a high of 68% in 1995/6 to around 54% in 2000/01 – in part because of changes in the tax benefits both to mortgage tax relief and insurance, but also because of market pressures. The vast majority of mortgages continue to be at variable rates or to be fixed for short periods of time or to include short term discounts. The proliferation of different

discounts and other variations in terms and conditions makes it difficult for households to assess what is best for their individual circumstances. What is clear is that the competitive system has not generated significant business in long-term fixed interest rate mortgages which would transfer interest rate risk from consumers to the market. In current circumstances such mortgages include a significant premium for transferring risk. How this should be addressed given the perceived benefits to the macro-economy is one of the questions considered by the Miles Review (2003 and 2004).

- With respect to (iv) both affordability and ease of access to funding can be assessed by examining three basic ratios: advance to income; repayment to income; and advance to dwelling price. These are set out in Table 3.3 for first time buyers. They show that the average advance to average declared income has risen fairly consistently since the early 1980s. The average repayment to average income rose steeply in the second half of the 1980s, as interest rates rose, but has now fallen back to levels similar to those observed in the 1970s and early 1980s. The average advance as a proportion of dwelling price increased in the 1980s, as lending became more flexible, but has again fallen back to less that 80%. Overall therefore the main evidence suggests that affordability varies mainly with the macro economic cycle. These are however average figures for first loans – they do not reflect problems at the margin nor the overall borrowing position of those who use more than one source of loan.

Table 3.3: **Advances to First Time Buyers**

	1975	1980	1985	1990	1995	2000
Number of loans	305	318	870	413	419	500
Average Advance to Average Income	1.94	1.67	1.94	2.19	2.21	2.30
Average Repayment as % Average Income	17.0	19.0	19.9	26.9	18.5	17.1
Average Advance as % Dwelling Price	76.4	73.8	85.3	82.5	89.0	79.7

Source: *Council of Mortgage Lenders*

- The most important variables which directly reflect the impact of deregulation with respect to affordability are arrears and possessions. On the other hand it should be remembered that there is a cost to not allowing people to borrow and they may end up borrowing from other sources on far worse terms than those available from mainstream financial institutions. Far more people were enabled to become owner-occupiers as a result of deregulation and some increase in risk could be expected to be optimal. The extent of risk faced by both institutions and borrowers in the 1980s and 1990s was inherently different from that experienced in the 1970s. This is particularly true because as the owner-occupation ratio rose to nearly 70% of households, the mix of those households changed to include many more at potential risk of unemployment, loss of income or household fission.

- There was a structural increase in arrears and possessions in the 1980s as new institutions entered the market and consumers were able to obtain higher levels of debt (table H.2). This could be argued to be an acceptable increase, reflecting the costs of expanding choice as compared to the 1970s when the very low levels of arrears and possessions reflected administrative constraint rather than correctly evaluated risk. The position in the late 1980s was very different and arose because of the juxtaposition of an overheated market, the rise in money interest rates and the deep recession, after a period of buoyant expectations, which was associated with very large increases in unemployment, especially among those who had just purchased their homes. This recession particularly affected London and the South East in a manner not experienced before. On the other hand possessions are now running at only 0.1% and mortgages over 12 months in arrears at 0.15% – giving perhaps a false sense of security because of the long period of economic growth experienced since 1995. Even so, unless and until macroeconomic conditions change, affordability, measured in terms of capacity to cope with mainstream housing debt, is under control.

Looking to the future

3.35 The policy of financial deregulation has undoubtedly had a massive impact on the types of housing policy that it has been feasible to implement and particularly on the effective growth of owner-occupation. It inherently leaves the housing market more open to external pressures, both positive and negative. Developing appropriate instruments to address this risk, and to enable the restructuring of timing of household expenditure/saving etc. is an area of continuing importance.

3.36 Although the market overall as been effectively deregulated it is actually subject to a growing number of regulatory authorities. The complex relationships between mortgage institutions, the Financial Services Authority and other UK bodies together with increasing European regulation are areas of growing policy interest and concern. However, the market is currently seen as being relatively sustainable although concerns about housing finance and housing market stability particularly in the context of entry into the Euro are now dominating political discussion (Miles, 2004).

3.37 Of broader concern is the extent of housing debt in relation to GDP. In 1980 the value of the owner-occupied housing stock in relation to annual GDP was 122 (with GDP as 100). In 2000 it was 196. The growth is partly explained by increases in the numbers of owner-occupiers and partly by increases in house prices. Housing debt was only 22% of GDP in 1981 but by 2000 that proportion had risen to 55% and has continued to rise thereafter. Obviously this provides far greater freedom for homeowners to organise their finances over their lifetime. However it also raises issues of their capacity to assess risk – as well as wider questions about macro-economic management. In this context it should be stressed that the effects are not all negative. As compared to our European partners small changes in relevant variables have a better chance of achieving macro-economic objectives, if at significant potential cost to the housing market.

3.38 Future areas of concern relate to:

- the financial services aspects of regulation;
- the impact of Basle 2 with respect to liquidity, and the mix of funding sources;
- the potential for increasing stability in the market through fixed interest rate mortgages;
- the extent to which new insurance products will mitigate the costs to consumers and the market in future recessions – an area which is currently completely untested;
- the potential for increasing the use of secondary markets and more complex hedging instruments;
- the potential for standardisation of mortgage and savings products to enable the realisation of greater economies of scale;
- pressures to improve the regulatory framework and to transfer risks; and
- the potential for housing equity release to substitute for pensions and other saving – and its associated risks.

3.39 Overall factors external to the housing market remain more important than housing policy itself in determining both the impacts and outcomes of financial deregulation. If policy is to be sustainable it must be able flexibly to adjust to these changing macro-economic circumstances in such a way as to maintain confidence and affordability in the housing market.

(c) Deregulation of the Private Rented Sector

3.40 The deregulation of the private rented sector (Pro-forma 3.7) was identified as the Beacon policy in the private sector because it has more relevance to the future than the tax and financial deregulation policies which have in many ways run their course.

3.41 In 1975 the private rented sector had been subject to continuous control over large parts of the market since 1915, affecting both rents and security of tenure and impacting on both the regulated and unregulated sectors of the market. Partly because of this regulatory regime and also because of differential taxation frameworks and incentives for owner-occupiers and private landlords as well as preferences, the result had been continuous decline in the private rented sector. By 1975 the proportion of the stock that was in the private rented sector was around 13% – of which around 25% was held by virtue of employment and around 60% was subject to controls, leaving perhaps 15% of the private rented sector, i.e. around 2% of the total stock available as easy access accommodation (Department of Environment, 1977).

The process of deregulation

3.42 By 1975 the Rent Act 1974 had been put in place. This made the distinction between resident landlords and non-resident landlords, with tenants of the second group having full security and being subject to fair rents. These rents were subject to revision every three years. At the same time rent allowances became available for all eligible private sector tenants both providing secure income to landlords and affordability for tenants who could find accommodation. Thus the basic elements were there to enable deregulation although it took some time to achieve.

3.43 Deregulation was mainly implemented through two pieces of primary legislation – the Housing Act of 1980 and 1988. The first put in place two new tenancy types – shorthold which gave security for between one and five years together with fair rents and assured tenancies which were applicable only to new or substantially renovated properties owned by approved landlords where rents were agreed between the landlord and tenant and terms and conditions were modelled on the law that applied to business premises (i.e. long-term security but at market rents). At the same time existing tenancies were all converted into fair rent tenancies with three year rent reviews (Whitehead & Kleinman, 1986). The impact of these policy changes was quite limited, especially as the associated tax incentives to assured tenancy investment were short-lived (Crook *et al*, 1991).

3.44 The 1988 Act built on this framework to ensure that all new lettings were either assured tenancies now available to any type of landlord, or assured shorthold lettings, which were for a fixed period of time with the rent set by agreement (Whitehead & Kleinman, 1996 and Shelter, 2002). Fundamentally the 1988 Act completed the process of deregulation of the private rented sector and set in place certain specified terms and conditions within which landlords and tenants could agree rents. Since then, almost all private lettings have been on assured shorthold terms. Assured tenancies have been found only in the housing association sector.

3.45 In addition to these two Acts there has been a wide range of more minor legislation changes to make case law more transparent, to improve contractual processes, to maintain standards, to deal more effectively with disputes and to change tax incentives. It is currently the intention to introduce new legislation in 2004, which will simplify and codify the law and move towards a more consumer oriented approach to landlord/tenant relations such as that found in Australia and New Zealand.

The relationship between deregulation and housing benefit

3.46 The effective deregulation of the private rented sector – particularly its political acceptability – depended crucially on the availability of rent allowances and subsequently housing benefit, which ensured that those on the lowest incomes would be fully protected from any rent increase and, at least in principle, that all potential tenants had the buying power to obtain adequate accommodation on the market.

3.47 The practice was more complicated and involved a great deal of administrative intervention with associated regulatory costs. Initially, of most importance was the question as to whether the availability of generous allowances, where eligible tenants paid no part of any increase in rent, market rent could be appropriately set such that public expenditure could be prudentially monitored (Whitehead & Kleinman, 1986). The processes involved are discussed in section 6. From the point of view of deregulation their importance is that they inherently required strong, and often changing, regulatory constraints and delays which impacted on landlord confidence and tenant well-being.

3.48 Equally the recession of the late 1980s and early 1990s meant that landlords who had let to employed tenants and expected to continue to do so found themselves with tenants dependent on housing benefit – which, while it ensured the rent was paid resulted in significant additional transactions costs.

3.49 The result of this interface between deregulation and tenant support is that, to a significant extent, there is a segmented market between those landlords and tenants who agree rents and conditions on equal terms and that part of the market where the administrative system, by determining eligibility and making the payments, dominates the process.

The impact of deregulation in the private rented sector

3.50 The government's hope was that the outcome of the 1980 Act and particularly of the 1988 Act would be to increase rents enough to expand supply from a wide range of landlords but that that increase in rents would be limited by the reduction in the risk borne by landlords as a result of the removal of rent control. The objective was undoubtedly to expand supply but as important was to generate greater flexibility which would, in turn, assist labour market adjustment.

3.51 The fear was that, as had happened on earlier occasions, decontrol would simply speed up the process of decline and not provide adequate incentives to potential landlords to provide additional investment. To some extent that fear was associated with whether landlord expectations about the future could be effectively addressed. However it also related to the incentive for tenants who could afford it to enter owner-occupation, on the one hand, and the available risk/return on other investments open to landlords on the other. Thus the potential size of the market was not well defined; success depended on fundamental change in the way that both landlord and household expectations were set (Whitehead and Kleinman, 1989; Whitehead (ed), 1994).

3.52 The actuality was that numbers in the sector did start to increase after a while – although by relatively limited amounts. In 1988, Housing and Construction Statistics estimated the size of the sector in England as 1.85 million – 9.6% of the total stock. This figure increased in numbers terms consistently until 1999 when it was estimated at 2.4m. It was then thought to have started to decline. In proportionate terms it fell in 1989 but then rose consistently to 11.4% in 1999. The Survey of English Housing suggests a rather different pattern with considerable falls initially and an increase to only 2.2 million on 2000. The figures in the 2001 Census suggest that both of these may be underestimates – especially once rent free accommodation is taken into

account. Accepting that there are many inaccuracies in both the base figure and the current estimates, it appears that the size of the sector has increased by between one quarter and one third since deregulation. On the basis of the census, as currently modified, the increase would be at the higher end.

3.53 Equally important, is the change in the types of letting that has taken place. In 1988 over half of all lettings were regulated and one quarter inaccessible to the public (table 3.4). The 1980 Act had made very little difference to the earlier picture. By 2000/01 nearly 60% were assured shorthold tenancies and fewer than 20% were not accessible to the public. The proportion of the total stock which was in the easy access sector had increased from less than 2% to between 6 and 7%. This is still apparently quite small by international standards – but implies an increase of at least 300% since 1988 in easy access accommodation. Given the relative flexibility of the sector (as compared to many other countries which still have elements of regulation) and of the owner-occupied sector this may reflect something close to long term equilibrium unless there is further policy change (Whitehead, 1998).

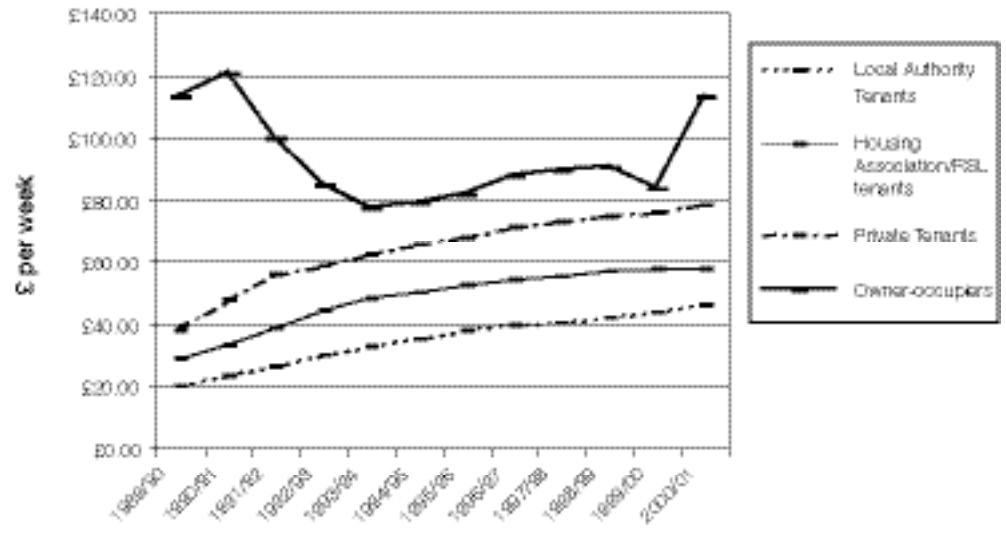
3.54 Evidence on rents is fairly limited. However what there is suggests that the rate of increase at the bottom end of the market has been, if anything, slightly less than for housing association and local authority rents (Figure 3.1). There are also some examples of rent decreases particularly in London both in the early 1990s and again particularly in the early twenty first century. However rents as a proportion of average male earnings have risen from around 17% in 1989 to 22% in 2000.

Table 3.4: **The Private Rental Sector; Types of Lettings**

	1988	**1990**	**1995/6**	**2000/01**
Assured	–	360	374	213
Assured shorthold	–	140	945	1,221
Protected shorthold/ pre 1989 assured	60	40	–	–
All Assured	60	540	1,319	1,434
Regulated	1,070	590	272	122
Not Accessible To Public	510	480	428	382
Resident landlord	110	90	209	192
No security	60	90	26	56
TOTAL	**1,810**	**1,790**	**2,254**	**2,186**

Sources: *ONS Housing in England & DTLIR Survey of English Housing*

Figure 3.1(a): **Average weekly housing costs 1989/90-2002/03**



Source: Dataspring

3.55 The number of private tenants in receipt of housing benefit has varied with the economic cycle, rising to 1.2m in the middle of the 1990s across Great Britain. This suggests that over half of those in the sector in England were in receipt of benefit. This figure has now fallen to under 750,000 i.e. fewer than a third of private tenants. The underlying figures (as opposed to those arising from cyclical factors), although somewhat difficult to interpret with certainty, do suggest that a significant proportion of the increase in the private rented sector was taken up by lower income households who could not obtain access to the social sector. As such, deregulation of the private rented sector has helped meet housing need perhaps at lower direct cost than would be the case in the social sector – especially where the requirement is short term (DETR, 1997; Holmans *et al*, 1998).

3.56 Equally it is clear that far more younger households have chosen the private rented sector before entering owner-occupation and the average age of entry into owner-occupation has risen significantly. This is generally seen as improving both the flexibility of the labour market and the sustainability of the owner-occupied sector – even though direct costs have often been higher.

3.57 A final question relates to the types of investment attracted into the private rented sector. In the main there has been limited interest from institutional investors – and pressures to introduce tax breaks to make such institutional investment worthwhile have until now been resisted by the Treasury. The introduction of the Business Expansion Scheme in the late 1980s did help to bring individual investors into the market for a short period – assisted by intermediaries. However, much of the investment went into lower risk investments in the housing association or student hostel sectors rather than into mainstream private rented housing (Crook *et al*, 1991; Holmans *et al*, 2003). Earlier attempts to bring in accelerated depreciation after the 1980 Act were too short lived to generate any positive results.

3.58 The vast majority of new investment in the private rented sector that has taken place has been undertaken by individuals. Much of this has come from the existing stock and can readily be transferred back into owner-occupation – as appeared to be happening at the end of the century. Over the last few years however there has been growing interest in Buy to Let, mainly from individuals but also from companies. Housing finance institutions, including centralised lenders, have found it a good source of business and investors concerned about the stock market and observing continuing capital gains in housing have seen it as a good investment. Some of the stock which is regarded as particularly appropriate for Buy to Let has been new apartments in inner city areas. Much has simply been ex HMO (houses in multiple occupation) or owner-occupied housing. There is some suggestion that the rapid expansion of the sector has helped to reduce rents – although this may also be a function of declining demand, especially in London, as the economy has slowed down. While Buy to Let has been an important part of the market in the last few years, it is not clear how sustainable it is especially if the stock market improves, if people have to realise their investments for other reasons, or if expectations about future capital gains decline. Similar patterns of demand have been observed in other countries with mature stock markets (Scanlon & Whitehead, forthcoming).

Overview on private renting

- Overall the deregulation of the private rented sector has been a successful policy. The expansion of the sector has been significant, if not as large as many commentators would have wished. The switch to easy access accommodation has been accomplished with surprisingly little political fallout. Rents have risen relatively slowly, although the costs of renting remain high as compared to owner-occupation by international standards (Freeman *et al*, 1996; Scanlon & Whitehead, forthcoming).

- Across the country accommodation is readily available, and the sector has borne much of the strain of housing those in need who cannot be accommodated in the social sector.

- By international standards the sector remains small – partly because of the scale of social provision and partly because of the relative tax benefits which owner-occupation still attracts. But it is also about the nature of the housing stock and the lack of appropriate accommodation enabling the realisation of economies of scale in management and maintenance, and about the continuing aspirations of many households to become owner-occupiers.

- Rates of return on rents alone are not large enough to attract significant investment, especially by institutions. Without further changes in the tax regime and/or large scale changes in preferences, especially by younger households, it is unlikely to expand significantly except at the expense of the social sector. The potential introduction of REITs is seen as one way towards developing a more sustainable sector with institutional funding but this addresses only one element of the equation (Barker, 2004).

- Other continuing problems are associated with repair and maintenance in the lower end of the private rented market and in the impact that poor quality private housing can have on neighbourhood. The loss of longer term contracts and the continued lack of relationship between rents and housing quality in the private rented sector makes this problem more acute (Crook and Kemp, 2003). Some of these problems are being addressed by licensing and by the implementation of the decent homes standard – although here the mechanisms by which investment can be encouraged remain unclear and the potential negative impacts on supply have not been evaluated (DETR/DSS, 2000).

- Questions about the role of the private rented sector in the broader economy are much less clear cut. A great deal of discussion has taken place in relation to whether the lack of a well-operating private rented sector decreases flexibility in the labour market. The immediate answer would seem to be that the rental market is now providing in relation to demand – but demand remains relatively low because of attitudes to renting, relative returns and continued expectations of increasing benefits to owner-occupation. Equally it has been strongly argued that renting makes more sense than owning in terms of household portfolios and the risks and illiquidity associated with ownership of a single specific asset (Caplin *et al*, 1997; Caplin *et al*, 2003). These are aspects of the broader question of the effective management of risk and the structuring of housing cost over time, which are only just starting to be addressed.

4. Social Housing Supply Subsidies and LSVT

Introduction

4.1 The period covered by the evaluation has been one of considerable change and re-direction of social housing supply subsidies. Key changes occurred in 1974 (the residual HAG system introduced), 1977 (Housing Investment Plans for local authorities), 1980 (HRA revenue funding and capital funding regimes), 1988 (mixed finance model for housing associations; large scale voluntary LSVT transfer begins), 1989 (new capital and revenue funding regimes for local authorities) and post-1997 (LSVT policies, the emerging new financial regime for local authorities, rent convergence, etc.). There were also many smaller capital and revenue funding changes, which have cumulatively impacted on the system and the housing it delivers. At a more general level, the period has seen shifts from supply to demand side subsidies, a move towards capital on the supply side subsidy rather than revenue; greater regulation of social housing finance; greater focus on asset management; and, only latterly, efforts to reduce the real cost of provision.

4.2 As we indicated above, the shifts in financial frameworks for social housing and the consequent changes to outputs and outcomes also have to be located in the wider context of broader economy-wide pressures. Of particular relevance to social housing finance are the emphasis on reducing public expenditure; privatisation; reallocation of risk; and the distribution of income at the lower end of the housing market. This last has been a particular consequence of the process of polarisation of housing tenure over the 25 years.

The Policies

4.3 The focus here is with supply subsidies and their associated regulatory framework in the social sector. Particularly we will emphasise the funding regimes of both local authorities and RSLs over the period. To what extent has the revenue-financing framework for local authority housing evolved? How has the capital funding of housing associations developed? How have policies aimed at restructuring social housing finance and institutional arrangement (particularly LSVT) worked? The core financial policies used to support social housing, supply subsidies, were aided by large-scale changes in regulatory and legislative frameworks in which social providers operated. The most important of these were: limiting the power of councils to build; supporting the introduction of private finance for housing associations, increasing incentives for councils to transfer their stock to the RSL sector; and a series of changes to rent determination in both sectors with impacts on affordability, financing and transfers.

4.4 The Beacons policies emphasised in this section cover to RSL supply subsidies (Pro-forma 3.8) and LSVT funding (Pro-forma 3.9). However, we also make reference to both local authority revenue and capital funding and to changing rent determination in the social sector (Pro-forma 3.10). It would not make sense to ignore these closely interlinked elements even if one was only trying to evaluate e.g. the LSVT policy process.

Objectives

4.5 Neither supply subsidies nor LSVT are neatly described in terms of clear policy objectives. Social housing subsidy systems have been operating for many decades but have been amended incrementally (though in some case with significant changes) over the period of evaluation. At the same time, LSVT emerged as a locally initiated policy that only subsequently became adopted and driven from the centre.

Supply Subsidies

4.6 Local authority capital finance was ostensibly designed to allow councils to borrow for new house building and other investment in the local authority housing stock. After the economic dislocations of the mid-1970s, macroeconomic arguments meant that the control of capital spending increasingly dominated other housing objectives. Indeed, a policy initially aimed at instigating planned council housing investment, the HIP system, was rapidly turned into a control mechanism in the face of macro-economic pressures. Other capital spending objectives included using top-slicing of capital budgets to shape housing investment into specific forms of area regeneration, for instance, those including private sector initiative or tenure change. Over the period, another increasingly important objective has been to integrate capital spending by councils across all headings rather than separately to plan and fund housing investment.

4.7 Revenue and expenditure relating to *council* housing organised in a well-specified housing revenue account (HRA) pre-dates the evaluation period. The HRA system was designed to produce a transparent financial framework for rents required after subsidy given spending needs on the housing stock. Since 1980, the system has been modified to enable central government to influence average rent levels through manipulation of notional subsidy (including, since 1989, the cost of rent rebates) and allowance levels for maintenance and management spending. Government argued (until the mid-1990s) that council rents were too low and consequently average rents were increased until the impact on housing benefit was recognised (Holmans & Whitehead, 1998a). Thereafter the emphasis has moved to rent coherence policies. Until the present Government's shift in direction towards resource accounting, business planning, major repairs allowance and prudential borrowing, the HRA framework has not been concerned with the real long term cost of providing housing (e.g. there was no adequate treatment of depreciation or the replacement value of the stock).

4.8 Although the *RSL* sector is partly constrained by public spending, it is reasonable to characterise policy objectives in terms of providing a funding mechanism to facilitate the growth through investment in the sector (with the limits set annually by the Approved Development Programme). The 1988 system sought to build on the 1974 system by producing an efficient (in terms of incentives) mechanism, involving lower rates of per unit grant, competition for funding, private finance, 'affordable' sub-market rents and an appropriate regulatory framework to enable growth. The 1988 model is also distinctive compared with council housing because it incorporates a sinking fund or element for depreciation within a more modern, business planning framework (although there is no requirement or incentive to use the funds in this way). It was here that Government explicitly made the notion of affordability a key objective, although they failed to provide it with a clear operational definition.

LSVT

4.9 Stock transfer from councils to the RSL sector has had different policy objectives over the evaluation period. Initially, the policy emerged locally though it evidently fitted with government policies to reduce the council sector and promote RSL housing. The policy also had the objective of re-financing social housing in order to use existing equity to provide investment in the existing stock at the time of transfer through the use of private finance. In the early 1990s central Government placed restrictions on the policy in order to prevent increases in public spending arising from the funding of housing benefit and also to reduce local monopolies after transfer. From the mid-1990s, government came to view stock transfer as a possible vehicle for area regeneration as well as a mechanism for introducing private sector pressures to increase efficiency and consequently provided subsidy to make deficit transfers viable. The present Government seeks to increase significantly the rate of transfer, whole and partial, with the objective of securing greater investment and as one of the chief ways of achieving the decent home standard. Another important objective of transfer is to protect the affordability position of tenants through rent guarantees and long term affordable rents, computations of which are critical to the initial stock valuation process.

Sequential Policy Analysis

The 1970s

4.10 The period can be described as housing policy at the behest of macroeconomic policy (although several frameworks were first established in this period and later became central to affordability and finance). A difficult macroeconomic environment led, for example, to council rents being held down as a form of incomes policy. Macroeconomic policy failure led to public spending controls that fell disproportionately on housing and led directly to falls in new build. The Housing Investment Plan (HIP) mechanism was used as an expenditure control device. This also created the separation of rent determination from the real costs of provision. At the same time flat real rents reduced the scope for property improvement in the social sector. There were also large book value increases in the social housing stock. In the midst of all this the 1974 residual Housing Association Grant (HAG) housing association finance model was developed. In the council sector, policy responded to expenditure reduction and viability pressures through the introduction of residual subsidy that created the future potential for more centralised control. Fair rents were introduced for HA housing and these were affordable though not related to costs (and had the additional benefit of separating investment from affordability questions for new association investment and rent-setting).

The 1974 Housing Association Funding Model

4.11 The model was introduced to provide a coherent funding framework from which associations could develop and replaced a system that could not deliver such growth. The 1974 model involved a simple residual grant system. A loan (from the Housing Corporation) was calculated on the basis of a property's fair rent minus allowances for management and maintenance. This residual loan was subtracted from the capital cost

of the dwelling leaving, typically 80% but sometimes up to over 100%, to be met by an upfront capital grant (HAG). Associations had no incentive to economise on capital costs and the Corporation had to establish a substantial bureaucracy to keep costs reasonable. Fair rents grow through time because of inflation and with the model based on first year project outgoings, housing associations naturally moved into operating surpluses over time (provided fair rents grew quicker than M&M allowances). Thus in 1980, a new instrument, the Grant Redemption Fund (GRF), was introduced as a claw back for these surpluses. Revenue deficit grant remained available to pre-1974 model funding and to some new and small associations.

The 1980s

4.12 This period was broadly about decreasing public expenditure and increasing rents in the social sector within a context of major tenure shift out of council housing and into owner-occupation. The 1980 local authority HRA system initially put councils rents under central control but this potential lessened as rents rose and fewer councils were eligible for subsidy and hence central influence diminished (until a new system replaced it in 1990-91). The 1980 system increased revenues but controlled expenditure with the long-term effect of reducing supply subsidy (which was effectively transferred into personal subsidies as rents rose and the proportion of tenants dependant on welfare increased). In the housing association sector, the large surpluses generated by the fair rent residual HAG system led to the claw back of excessive subsidy turning the system into something akin to an index-linked loan rather than a capital grant (Hills, 1990). The patent inefficiencies with the 1974 system led to pressures to change the whole basis of funding voluntary sector housing.

1988/1989

4.13 Three major reforms of the social sector took place fundamental to affordability and finance. First, the mixed funding model of housing association finance was introduced characterised by fixed capital grant (with competitive bidding arrangements), private lending, affordable rents, assured tenancies, and a sinking fund for long term repairs. Second, local authority housing finance was reformed (1989) both to introduce the ring-fencing of the HRA and to bring almost all councils back into subsidy through the combining of rent rebates and exchequer subsidy, in effect, taking surpluses away from councils. Capital funding rules were also further tightened. Third, councils began examining the potential for and implementing large-scale stock transfers to associations based on a privately funded tenanted market value of the stock as a going concern (subject to ballot and Secretary of State approval). Debt finance raised in this way was increasingly used to fund stock improvements off the Exchequer balance sheet.

The ‘mixed funding’ new housing association financial regime

4.14 The 1988 reforms to capital funding aimed to complete the job of the 1974 model by removing inefficiencies, transferring risk, encouraging private sector leverage and making a long term commitment to the asset management of the new stock. The new model pre-determined (far lower average) levels of HAG and made the loan component, now privately-funded, the residual element. Rental income, based on

below market cost rents (affordable rents) would have to cover three major components: private loan repayments, M&M costs and a long term sinking fund (a form of depreciation allowance). The sinking fund element effectively replaced the previous system of major repairs grants through HAG with a self-funding revenue-based scheme requiring separate accounting. It was assumed that low start finance would reduce front-end-loading problems though in practice associations mainly employed conventional debt finance. Under the new system the risk of overrun was passed on to the association and they had to deal directly with private lenders. In the long term these changes have greatly changed the culture of the sector. Under the new regime, GRF was replaced with the rent surplus fund, which partitioned surpluses into funds for major repairs, reserves and funds to be repaid. Over time, associations came to use their reserves more aggressively to help fund new investment, to reduce the costs of private finance and to allow them to bid down actual grant rates.

Fluctuations in the ADP

4.15 In many respects the progress made through the 1974 and 1988 models of housing association finance produced a sustainable and incentive-compatible funding mechanism. Associations learned how to work with lenders and The Housing Finance Corporation (THFC). They are more business-like and have generally coped well with the new risks they face. Rents on new properties have generally remained below market levels, even if the affordability questions have not always been satisfactorily resolved. Initially there were some criticisms of the quality of the house types, sizes and estate layout of new developments but this has largely been overcome (see Theme 3: Housing Quality).

4.16 The most important area where the system's adequacy continues to be put in question is the vulnerability of the resourcing of the wider Approved Development Programme (ADP). The ADP is an annual programme that has been subject to short-term public expenditure fluctuations. In recent years, the programme has been significantly hit with knock-on reductions in mixed funded completions. In part, this has been offset by non-traditional funding (e.g. cross-subsidy from private developers as part of the deal to provide mixed tenure housing development) but does not compensate for the widely recognised deficits in new affordable housing in recent years (Holmans *et al*, 1998b and 2004). The ADP has been distributed regionally by different, more or less transparent, and formulaic models of need. This has not always produced satisfactory or apparently sensible outcomes, concentrating assistance often in higher cost but sometimes also low demand areas.

Large-scale voluntary transfer (LSVT)

4.17 In essence, LSVT involved a council selling its stock as a going concern to (almost always) a registered social landlord in a transaction funded by private finance, including provision for catch-up repairs. The vast majority of these recipients have been management buyouts although an increasing number are now existing mixed funded organisations. The council shifts to an enabling or strategic role (plus residual

functions such as homelessness responsibilities) and may use part of the net capital receipt to reinvest in the transferring landlord, usually in the form of capital funding for new developments. It is thus, from the Government's point of view, a way to refinance housing privately and use existing equity to pay for improvement investment while retaining the rights of transferring tenants. It originated as a bottom-up response to control from the centre (particularly with respect to surpluses and discretion over future capital programmes). After a period of constraining regulation (limiting the size and number of transfers after 1992) and then innovation the Estates Regeneration Challenge Fund (ERCF) which enabled 'deficit' authorities to transfer in specific circumstances), the policy was revitalised by Labour's election in 1997.

4.18 The initial period was characterised by locally led initiatives seeking to escape into the (perceived) liberal housing association regulatory environment and to capture the asset appreciation of the stock through a capital receipt that would benefit local tax payers. The differential treatment of housing benefit was also of potential relevance. The early transfers were dominated by Liberal and conservative councils often in the South and West of semi-rural England though also Bromley LBC) with relatively small stocks in good condition and large positive stock values. Valuation was based on a tenanted NPV of net income at a conservatively high discount rate. Original models which included income from council house sales were dropped after the housing market downturn led to lower than predicted sales and corresponding cash flow problems. From its inception, there has been considerable criticism of the high transactions costs: consultants, legal/financial advice, balloting, Chinese walls, etc. associated with transfers, particularly where they failed to proceed and of some poor financing decisions, notably with respect to fixed interest rates. Moreover, now that transfer has moved much further down market into negative residual value stock transfers, and regulatory requirements imposed by the government have increased, these transaction costs have risen further. Even so, the margins on funding have significantly declined.

The 1990s and Now

4.19 Key themes in the 1990s for social housing were the shift towards efficiency based as opposed to need-based supply subsidy allocations; the emerging strong commitment to separating the strategic and operational functions of council housing provision; the development of policies such as rent regulation to offset some of the more adverse features of the 1980s policies; the rise and then fall of the overall resources allocated to building new homes through the ADP[1], and, first limited then more wholehearted support (after 1996) for LSVT, including providing lump-sum subsidy to make negative valued transfers 'stack-up'. For most of this period the economic environment has been more benign and thereby allowed policy to develop, assisted by the maturation of private funding to social housing. This allowed developments in areas such as risk transfer without having major implications on affordability. Associations were also encouraged to fund investment through accumulated reserves which in turn obliged them to raise rents, until rents were increasingly regulated after the mid-1990s culminating in the on-going rent convergence process which has once again separated rent determination from actual costs.

1 These resources have increased again since the end of the evaluation period.

Stock Transfers since the early 1990s

4.20 LSVT slowed down in the early 1990s but was then revitalised by deficit transfers and Labour's greatly increased commitment to the process. The first Major government was concerned about LSVT running out of control; that it might be anti-competitive; and that it would raise the Housing Benefit bill. As a result, from 1992, the number of transfers per annum was limited, the maximum size of individual transfers was capped (a crude anti-monopoly policy) and a proportion of the capital receipt was returned to the Treasury as a one off 'tax' to compensate them for the lost funding for Housing Benefit as a result of the transfer. This last measure in particular, reduced the financial attractiveness of transfer since it operated on the net receipt after housing debt was cleared.

4.21 LSVT initiatives shifted down market in the mid-1990s when the government decided to favour estate transfers in situations where the stock had overhanging debt problems (i.e. the tenanted market value was less than the outstanding housing debt attributable). By using ERCF, government was able to transform LSVT from a richer rural and suburban council policy to an urban regeneration instrument. Since 1997 the Government has actively encouraged a much larger LSVT programme by removing size and number limitations and providing additional financial mechanisms to alleviate overhanging debt. This has led to some large stock transfers in cities like Sunderland and Coventry but has not prevented ballot failures in cities such as Birmingham.

Sustainability

4.22 The 2000 Green Paper proposed that 200,000 units should transfer each year for 10 years from the council to the RSL sector. Current policy for social housing is being shaped by the options appraisal mechanism by which individual councils can meet the investment requirements of the decent homes standard. In part, the choice between traditional provision, whole or partial transfer, Arms Length Management Organisations (ALMOs) or Public Private Partnerships (PPP) reflects the existing housing circumstances facing the council (in terms of housing conditions, debt, etc.) but it also reflects the new housing finance arrangements being developed and implemented by ODPM alongside a stringent performance review by the Housing Inspectorate. Incentives for transfer remain strong and have been further increased through help to meet brokerage finance costs and debt support for partial transfer.

4.23 In the RSL sector, the 1988 system is now mature and stabilised, helped by earlier rent increases and declining ability to build new homes and take on further commitments (because of the decline of the ADP). Future pressures stem from the decent homes standard and rent convergence threatening financial viability of some RSLs and increasing pressure to cut costs.

Evaluations of LSVT

4.24 A recent study of the evaluation literature on LSVT (Gibb & Maclennan, 2003) concluded that:

- post-transfer tenants tend to demonstrate high satisfaction levels with their new landlord. Sceptics seem to have been persuaded by better performance and by the delivery of ballot pledges on rents, improvements and service. There is a more mixed message on genuine tenant involvement with smaller, local and new transfer organisations tending to be more participative than existing RSLs who add transferred stock to their portfolio;

- staff morale appears to have been low during the uncertainty of the transfer process but in general to have risen thereafter because of improved opportunities, more diverse work, changes in staff and the like;

- councillors have to come to terms with their new role as enablers and their reduced, though important, role in overseeing the delivery of residual housing services by the local authority;

- LSVT has been a primary driver in the changing culture and ethos of the RSL sector. LSVTs now increasingly dominate the RSL sector (measured in terms of stock) to the alleged detriment of traditional voluntaristic associations;

- performance, though difficult to measure, is generally favourable towards LSVT associations both in terms of meeting initial objectives, tenant satisfaction and on general management indicators. There is, however, no literature to date on the wider and long-term impact of LSVT investment.

4.25 LSVT progress has reshaped the RSL sector. A profile of this element of the RSL sector (Kiddle, 2002) suggests that units transferred remain geographically concentrated in the South East, South West and London but that Metropolitan districts have become more involved in transfers in recent years (particularly in terms of poorer quality stock in partial transfers).

4.26 In 2002, the Audit Commission assessed the role of local authorities after transfer, stressing the effectiveness of local authorities and their retained roles once they are no longer a provider (Audit Commission, 2002a). They found that, after transfer, the services provided by councils did not always improve. In particular, councils had difficulties ensuring housing service shad sufficient capacity to respond to new initiatives and meet wider council aims or build effective working relationships with local providers. Councils also found difficulty in reducing their overheads to match lower revenue sources after transfer. Accountability and responsibility for leading, funding and monitoring frequently became less clear.

4.27 A National Audit Office study (NAO, 2003) on stock transfer between 1988 and 2001 found that:

- more than £6 billion of private funded investment had gone directly into improving transferred housing, contributing to achieving the decent home standard (now a requirement of transfer);

- transfers also reduced the proportion of social housing owned by councils to 70% in 2001. In this context it was noted that, until 2001, there was a guarantee that tenants would be involved in the selection of the new landlord until the ballot;

- RSLs largely delivered the expected benefits of better quality services, although NAO argued that promises at transfer need to be more carefully monitored. The policy was also seen as having successfully transferred financial risk to the providers of the social housing;

- financially, the tenanted market value model was however regarded to be inflexible and not always capable of achieving VFM for taxpayers. Evidence suggested that post-transfer foreseeable risks had not always been adequately dealt with at the time of transfer nor in terms of initial financial calculations;

- although the lifetime costs of transfer to the public are higher than earlier thought, the NAO argues that transfer has delivered considerable compensating benefits to society e.g. through urban regeneration, bringing forward repairs, etc. and has overall provided value for money; and

- Finally, the study suggested that RSLs should be encouraged to use surpluses to further social housing objectives and to assist sustainable communities.

Overall Assessment of Social Sector Supply Side Policies

4.28 We begin the assessment by tracing out the main quantitative trends in public spending on social supply subsidies, output levels generated and the rents that resulted form the various systems in place. We then go on to make a more qualitative assessment.

Public spending

4.29 Capital spending by councils has shifted strongly into renovation (the bigger component since 1982-83 and more than 90% of the total since the early to mid-1990s). Overall spending has typically been around £1.5-2 billion (cash) over the period with larger sums (£2-4 billion) between 1987/88 and 1990-91.

4.30 Starting at a much lower level, RSL funding reached £1 billion in 1987-88, the last year of the old financial regime. RSL funding continued to grow and outstripped council capital spending in 1991-92 and has remained above it ever since (though in recent years the two categories have moved much closer together at correspondingly lower resource levels). RSL funding peaked in the early to mid 1990s between £2.1 billion and £3.6 billion (cash).

4.31 Revenue subsidy arrangements for councils have been affected by key regime changes in 1980 and 1989. Exchequer subsidy has moved from an inflow of more than £1 billion in 1978-79 to an outflow of more than £1 billion in 2000-01. Rate fund contributions were of the order of £567 million in 1983-84 but have since dwindled to single figures in the 1990s. Of course, since the 1989 reforms, rent rebates have been tied up with the Exchequer subsidy and further current reform plans will again change these financial relationships.

Output levels

4.32 At the beginning of the period, councils in England were still completing more than 100,000 units per year. This figure collapsed to fewer than 30,000 for most of the first half of the 1980s and to below 20,000 for the second half of that decade. Since 1994, council building has dwindled to an annual figure of fewer than 1000 units. RSL and housing association completions, closely linked to the overall annual ADP allocation grew to 24,000 units in 1977 before falling back to the 10-14,000 range for most of the 1980s. The new 1988 financial regime pushed completions above 30,000 units between 1993 and 1995. More recently, the figures have been between 15,000 and 19,000 although they have risen again since the end of the evaluation period.

Rent levels

4.33 Local authority rents trebled in cash terms between 1970 and 1980 (England and Wales) in the context of major inflationary pressures. Rent policy in the 1980s pushed up rents through subsidy mechanisms, increasing rents from £7.70 per week to £23.74 by 1990 (England, cash) By 2001, they had doubled again to £47.72 per week. In real terms, average council rents were flat in the 1970s, grew by roughly 50% in the 1980s and by about a third in the 1990s.

4.34 In the RSL sector from 1980 to 1989 average fair rents grew in cash terms from £12.52 per week to £26.83. Thereafter, the relationship between fair rents and assured tenancy rents has been one where the latter overtook fair rents only for fair rents to catch up and overtake assured rents as a result of regulatory pressure (Chaplin *et al*, 1995). RSL rents are well above council rents although the policy of convergence will modify this relationship over the next few years. Overall, although rents increased significantly – they did not greatly rise either in relation to rent to income ratios or in terms of international comparisons.

4.35 Who has benefited from the changing supply subsidy environment?

- The distributional effects have been muddied by housing benefit received by low-income households on the one hand and by the Right to Buy exercised by mainly better off households on the other. Over the period of the evaluation, the composition of the council sector has become more polarised with respect to society as a whole. At the same time, the RSL sector has come to take on more of the characteristics of the council sector. How much of this process can be attributed to rising rents in the council sector in the 1980s, or the rent increases associated with private finance in the association sector is unclear except possibly in terms of deterring entry (Holmans & Whitehead in Malpass & Marsh, forthcoming).

- Addressing the long term costs and depreciation of social housing has been adequately dealt with for post-1988 RSL housing but only now is it being addressed elsewhere. To some extent, therefore, the subsidy system has failed to achieve housing quality standards alongside affordable rents. In particular, the unevenness of supply subsidies over the period has had long term public exchequer costs (latterly being addressed) and this may indicate poor value for money for the taxpayer.

- Producer interests have been differentially affected by the supply subsidy environment. House builders lost the stability associated with large council house building programmes and this was not compensated for by the fluctuating RSL ADP. On the other hand, the shift into renovation and long term maintenance has had and will continue to have beneficial impacts on the construction industry. The private finance market, now concentrated in the LSVT segment, has raised new markets for lending (Wilcox & Williams, 2003). More generally, several RSLs have skilfully exploited the opportunities created by the new regulatory and financial environments and embraced the new social business ethos to capture growth opportunities in mixed funding, LSVT and regeneration markets.

- At the beginning of this section the shift from supply to demand-side subsidies was stressed. While it remains the case that large flows of public funds continue to reduce the cost of social housing each year, the mix of sources has clearly changed greatly over the period. This is not just in terms of the shift away from building to maintaining homes, it also reflects changing attitudes regarding the shape of subsidy. Should it be an up front capital grant with sinking fund elements designed into the structure (as with RSLs) for new build developments or should there be some form of on-going revenue subsidy into a well-defined and sustainable business account? The advent of business planning and the reforms underway for local authority housing finance, suggests some levelling of the playing field in terms of the existing social housing stock.

5. Housing Benefit

Introduction

5.1 Over the past 30 years a policy of housing allowances for tenants has moved from being a discretionary item of local authority expenditure to being the largest housing subsidy, and a major item in central government's social security budget.

5.2 Housing Benefit, as it has been known since 1982, has underpinned some of the major shifts in housing policy over the past 25 years (Pro-forma 3.11). Not only has Housing Benefit been a necessary component of the shift away from bricks and mortar subsidies in the social rented sector, it has been essential for other housing policies. These include the success of the post 1988 finance regime in housing associations, Large Scale Voluntary Transfers, private sector rent deregulation as well as securing both temporary and permanent accommodation for households under the homelessness legislation.

5.3 But there have always been concerns about possible adverse spillover impacts arising from Housing Benefit. These include lack of cost control, upmarketing and work disincentives. The administration of the scheme is also an area of official concern. More recent reforms to the scheme have tended to focus on these problems and it seems that the tension between them and the original objectives of the scheme have contributed to its alleged unsustainability in its present form.

Context: the British Social Security System

5.4 When analysing the British Housing Benefit system it is important to recognise its role within the wider social security system.

5.5 Following Beveridge's discussion of the 'problem of rent', the British social security system has tended to exclude allowances for housing costs from mainstream social security benefits. These include the national insurance benefits for unemployment and sickness, the basic state pension and the principal social assistance (or safety net) benefit (National Assistance/Supplementary Benefit/Income Support/income-related Job Seeker's Allowance).

5.6 Housing Benefit has allowed these benefits to be paid at relatively low levels by targeting assistance towards housing costs so precisely. This is particularly true of the state pension, many recipients of which are owner occupiers with no mortgage interest commitments.

5.7 Consequently, the *cost* of the HB system should be seen in the context of relatively inexpensive social security benefits and its *structure* (in particular its payment of the whole of the rent of many claimants) in the light of the absence of any allowance for housing costs in mainstream benefits.

5.8 These factors should also inform any comparisons with housing allowance systems in other countries where mainstream benefits are more generous and the relationship with social assistance quite different (see Kemp 2000; Stephens *et al*, 2002).

The policy and its objectives

5.9 The term "Housing Benefit" here refers to all of the means-tested benefits that assisted tenants explicitly with their rents during the period. It includes the rent element in Supplementary Benefit up to 1982, Rent Rebates and Allowances used from 1973 until 1982, Certificated and Standard Housing Benefit between 1983 and 1988, as well as Rent Rebates and Allowances, together known as Housing Benefit, since 1988.

5.10 The schemes can be characterised as having two related housing objectives. These are:

- to enhance housing affordability (an 'affordability' objective).
- to prevent post-rent incomes falling below an acceptable level defined by the basic level of social assistance entitlement (a 'safety net' objective).

5.11 These objectives operated alongside a policy of shifting housing subsidies away from bricks and mortar and towards personal subsidies for much of the period.

Sequential analysis

1970s: a False Start

5.12 The national 'housing benefit' scheme was introduced by Edward Heath's Conservative Government in 1972/73, following the publication of the White Paper, *Fair Deal for Housing* (DoE 1971). This noted that there 'is no longer an acute overall shortage of houses in most parts of England and Wales' (p. 3) and called for 'a radical change in housing policy' (p. 4). While retaining the objective of 'a decent home for every family at a price within their means' (p. 5), the White Paper introduced objectives of tenure choice and equality of treatment between citizens. To achieve these objectives, the subsequent Housing Act set in motion a process of setting rents in all sectors (private, local authority and housing association) in the same way, through 'Fair Rents' that would replace anomalous and unfair rent structures based on various rent control regimes and historic costs. The White Paper states that the Government's 'central policy of subsidising people, not bricks and mortar, will be carried out through the national rent rebate scheme' (p. 42), which replaced the individual schemes operated by local authorities.

5.13 The policy of rent restructuring, combined with the introduction of a national housing benefit scheme, was introduced just before the unanticipated oil price shocks that changed the economic environment from a benign one into one that rendered the policy impractical, at least for the time being. While the 1974-79 Labour Government retained the new housing benefit system, rent restructuring was abandoned for political reasons. In any case rent control became a central part of prices and incomes policies devised to counter inflation for the remainder of the 1970s.

5.14 During the 1970s, the housing benefit system suffered from several structural problems arising from the operation of two schemes side by side, i.e. the scheme operated by the DHSS and the scheme operated by local authorities. Some 400,000 people were entitled to support from either scheme, but the Supplementary Benefits scheme was the more generous of the two (Kemp 1984). Housing Benefit Supplement was introduced in an attempt to deal with this problem. "High Rent" schemes were also introduced as help under the rebate and allowance system was normally based on 60% of rent and this was felt to be inadequate in high rent areas (ibid.).

1980s: The Policy is Reborn: Unification and Narrowing of Objectives

5.15 By the time the Conservatives were returned to office in 1979, the emphasis of economic policy shifted away from prices and incomes policies and towards the control of public expenditure. Thus the policy of shifting housing subsidies from bricks and mortar to individuals was reactivated, but this time with periodic cuts in the generosity of Housing Benefit. Hence the general rise in the numbers of HB claimants was interrupted by a sudden drop in 1988. But as rents rose, the upward trajectory was resumed.

5.16 The development of Housing Benefit in the 1980s can be characterised as follows:

- first, there was a gradual rationalisation of the structure and administration of the benefit. In 1982/83 the administration of HB claims, previously the responsibility of the DHSS, were transferred to local authorities. While the administration of the schemes was unified, their structure remained separate, so many of the problems continued until 1988 when Housing Benefit was reformed as part of a wider review of the social security system;

- in 1988, the three means-tested benefits (Supplementary Benefit, HB and Family Income Supplement) that had grown up in an ad hoc way since the mid 1960s were finally co-ordinated, so removing the anomaly whereby someone could be actually worse off in work than out of work (the extreme version of the unemployment trap). Within the new system (in which FIS became Family Credit and SB Income Support), HB was itself "unified" and a "single taper" structure adopted. Households whose incomes were at or below IS levels received the whole of their eligible rent in HB. Thereafter it was withdrawn at 65 pence in the pound (after income tax and national insurance).

5.17 But the 1988 scheme also represented a narrowing of the objective of HB. Essentially, the scheme became more tightly focussed on providing a safety net for householders with very low incomes. The increases in the taper in the 1980s meant that the wider affordability objective was much reduced, if not wholly abandoned.

1990s: Shifting Subsidies from Bricks and Mortar to Personal Subsidies runs its course

5.18 In the 1990s, the perceived utility of HB began to decline. This may be attributed to the diminishing cost savings derived from raising rents in the social rented sector (DETR 2000). While HB had been fundamental to reducing bricks and mortar subsidies, and therefore of transforming the housing system, this transformation was now largely complete. From the mid 1990s Governments attempted to restrain rises in local authority and RSL rents, and to contain the costs of the HB system, even if this conflicted with the underlying safety net objective of the policy.

Assessment of Housing Benefit

5.19 An assessment of HB can be made by considering, first, the extent to which it has met its primary objectives. As outlined above these are to:

- prevent post-rent incomes falling below an acceptable level defined by the basic level of social assistance entitlement (a 'safety net' objective);
- enhance housing affordability (an 'affordability' objective); and
- shift housing subsidies away from bricks and mortar and towards personal subsidies (at least until the mid-1990s).

5.20 The assessment will then consider the principal alleged failings of the HB system, namely: (a) its impact on work disincentives, (b) upmarketing, (c) administrative costs and inadequacies. The pros and cons of HB can then be compared with its cost.

Achievement of Objectives

- ***Achievement of Safety Net Objective***

5.21 The basic design of the 1988 Housing Benefit system suggests that its function is to prevent post-rent incomes from falling below social assistance levels. But this objective is not an unconditional one and there are circumstances in which the safety net objective is not fulfilled. These arise when (a) in some instances where eligible households do not claim benefit, (b) in some cases where non-dependant deductions are applied to the eligible rent, (c) in some cases where eligible rent is restricted and (d) groups – notably students – who are barred from claiming benefit. Apart from (a) the implication is that the Government's cost control objective over-rides the safety net objective in these cases.

- ***Non-take-up***

5.22 Clearly, when tenants who are eligible for benefit do not claim it, then their post-rent incomes *may* fall below social assistance levels.

5.23 Non-take-up is a frequent criticism of means-tested benefits. Take up for Rent Rebates was estimated to have risen from 60-70% soon after its introduction to 70-75% by the end of the decade (DoE 1979, Table XX). Take-up for Rent Allowance was much lower – around 20-25% in 1973/74, rising to 50-55% by the end of the decade (ibid.)

5.24 Since then take-up has risen considerably (although figures before 1983 exclude SB payments for rent, the take-up of which may have been higher). Take-up by caseload is estimated to lie in the range 87-95% (for 1999/2000 and 2000/2001) while take-up by expenditure is estimated to be somewhat higher: between 91 and 97% (same years) (DWP 2003, Tables 2.1 and 2.2). There is some variation in take-up between different family types, but these variations are not dramatic. Estimates of take-up by tenure, suggest a somewhat lower take-up among private tenants (ibid., Tables 2.3 and 2.4). Take-up is higher than for many other means-tested benefits (DWP 2003, p. 26).

5.25 While take-up is generally lower among those whose entitlement is lower (i.e. have less to gain by claiming), the amounts unclaimed are likely to be sufficiently large to take post-rent incomes below social assistance levels in a high proportion of those eligible tenants who do not claim (see DWP 2003, Figure 2.1). Unfortunately, there is not a summary figure of the numbers affected available.

- ***Non-dependant deductions***

5.26 Non-dependant deductions (NDDs) reduce the eligible rent of claimants who have 'non-dependants' (such as adult sons or daughters) living in the same dwelling. In principle, the claimant should not suffer because the non-dependant should make a contribution to the rent. But is clear that the system is both complex and "family strife and hardship can result from the current arrangements" (Social Security Select Committee 2000, paragraph 30). By the nature of the problem it is not possible to give estimates of the numbers of households whose post-rent income is taken below social assistance levels as a result of non-dependant deductions and insufficient contribution from the non-dependant. A study by Witherspoon *et al* (1995) found that 7% of households in receipt of HB were subjected to NDDs, but this figure excludes those households whose entitlement to HB was eliminated by the size of the NDD. The study found that fewer than 40% of non-dependants living in households subjected to NDDs contributed nothing to the rent. However, this problem is likely to have grown as the deductions became more onerous in the 1990s.

- ***Other restrictions on eligible rent***

5.27 Housing Benefit has always contained provisions to limit benefit payments excessive rents, or rents on properties that are considered to be too large for the household's needs. The Single Room Rent (SRR) and Local Reference Rent (LRR) restrictions introduced in 1996 and applied to Rent Allowance claimants represented *additional* limitations. (The LRR restricts the level of eligible rent for private tenants to the average market rents of a given size in the area. The SRR restricts the eligible rent for most single private tenants aged under 25 to the median rent in the area for accommodation with exclusive use of one room only, i.e. with a shared bathroom, kitchen and living room.)

5.28 A study of all cases referred to the rent officer (i.e. Rent Allowance claimants) in 1999 by Kemp *et al.* (2002) found that rents were restricted in 70 per cent of referrals. Just over a quarter of claimants were affected by the pre-1996 restrictions only, a similar proportion by both the pre- and post-1996 restrictions, and 17 per cent by the 1996 restrictions only (ibid., Table 1).

5.29 The study found that the average restriction was £19 per week, and was "especially large in London and in cases subject to the single room rent" (ibid., p. 2). It is likely that in many of the cases where eligible rents are restricted, post-rent incomes will be taken below social assistance levels. As the protection offered to pre-1996 claims (the post-1996 restrictions apply to new claims) is eroded, the problem will worsen.

- ***Full-time students***

5.30 In 1990 most full-time students (i.e. those without non-student partners or dependant children) lost their eligibility to claim HB and other social security benefits (Stephens 1990).

Summary assessment

5.31 The basic design of the 1988 HB system is such as to prevent post-rent incomes falling below social assistance levels. However, cost control measures within the scheme, combined with additional cost-control mechanisms introduced in the mid-1990s, have considerably weakened the ability of the scheme to meet the safety net objective in the private rented sector.

- ***Achievement of the Affordability Objective***

5.32 The impact of Housing Benefit on Affordability ratios is indicated in Table 5.1, which shows rents as a proportion of income before and after Housing Benefit. It is notable that HB has consistently made appreciable improvements in affordability ratios in all rented sectors. It is strongest in the social rented sectors where high proportions of tenants receive HB, and much weaker in the private rented sector where far fewer tenants qualify and where much tougher restrictions on eligible rents apply (especially after 1996).

Table 5.1: **Impact of Housing Benefits on Affordability Ratios**

	Affordability Ratio (Before HB)			Affordability Ratio (After HB)		
	LA	**RSL**	**PRS**	**LA**	**RSL**	**PRS**
1993/94	23.0	25.5	34.9	12.2	13.8	23.3
1994/95						
1995/96	27.8	35.0	30.0	13.2	14.7	21.7
1996/97	25.9	29.3	25.9	11.7	14.4	19.7
1997/98	26.0	32.4	25.0	12.4	14.8	18.9
1998/99						
1999/00	25.6	33.9	23.5	11.7	15.8	18.4
2000/01	26.7	31.7	24.6	13.3	15.1	21.8
2001/02	26.2	30.9	25.3	12.8	15.7	22.8

Note: Affordability here is Rent as a % of Income (higher % = less affordable)
Source: Survey of English Housing (1993-2001)

5.33 It seems likely that the growing impact of tougher restrictions on eligible rent account for the declining impact of HB on affordability in the private rented sector (see Table 5.2 below). While the percentage reductions in rents as a percentage of incomes is reasonably stable in the social rented sectors (at around 50%), it has declined from 33% to 10% in the private rented sector since 1993/94.

Table 5.2: **Improvement in Affordability Ratios as a Result of HB**

	LA	**RSL**	**PRS**
1993/94	46.9	45.9	33.3
1995/96	52.5	58.0	27.6
1996/97	54.8	50.9	24.1
1997/98	52.3	54.4	24.4
1999/00	54.3	53.3	21.7
2000/01	50.0	52.4	11.3
2001/02	51.0	49.2	10.0

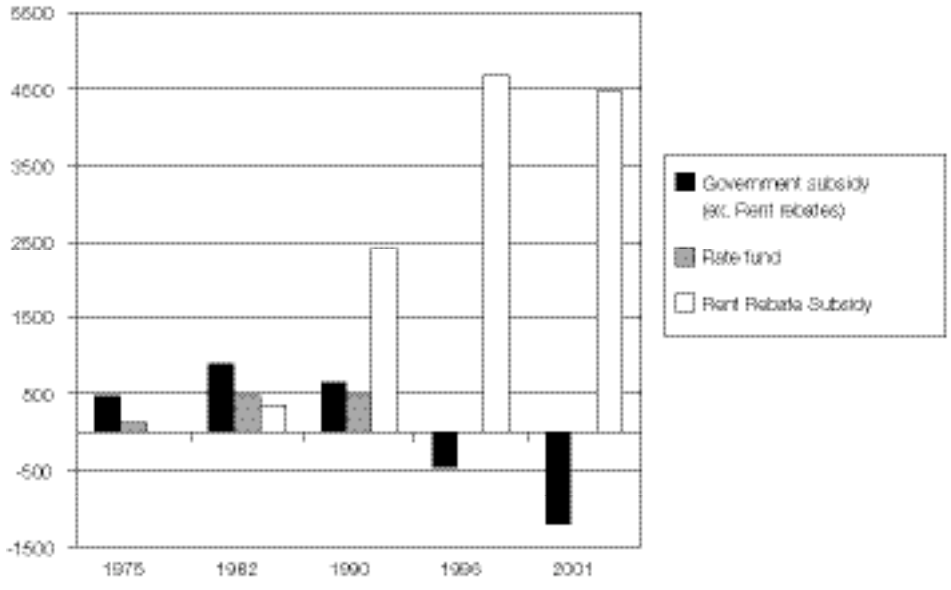
Source: Survey of English Housing (1993-2001)

5.34 HB makes a considerable improvement to the enhancement of housing affordability in the social rented sectors. However, it has much less impact in the private rented sector as a whole, mainly because fewer private tenants qualify. But there has been a marked downward trend in the impact of HB on private sector affordability. It seems likely that cost-control mechanisms introduced in the mid-1990s are at least partly responsible for this.

Achievement of Objective of Shifting Subsidies away from Bricks and Mortar

5.35 Figure 5.1 shows the dramatic impact that has occurred in the composition of subsidies to local authority Housing Revenue Accounts. There can be no doubt that subsidies have been very effectively shifted from bricks and mortar to personal subsidies.

Figure 5.1: **Subsidies to Local Authority Housing Revenue Accounts (England and Wales) 1974/75-2000/01 (£m)**



Source:
1974/75 and 1978/79 from *Housing and Construction Statistics* 1973-1983
1981/82 and 1989/90 from *Housing and Construction Statistics* Table 10.28
1992/93 and later from *Housing Statistics* 2001, Table 5.19

- ***Alleged Failings***

Adverse impact on work disincentives

5.36 Housing Benefit may damage work incentives through (a) the unemployment trap and (b) the poverty trap.

5.37 The unemployment trap exists where in-work incomes are either lower or not sufficiently higher than out of work incomes to encourage unemployed people to take paid employment.

5.38 The 1988 reforms of the social security system on paper removed the narrow form of the unemployment trap, i.e. leaving someone in work worse off than out of work. In practice, this can still happen if costs associated with work (such as travel), or the loss of "passported" (contingent) benefits (such as free school meals) exceed earnings disregards. But the wider unemployment trap, i.e. those left not much better off in work persists, although measures such as Working Families Tax Credit/Working Tax Credit are intended to improve the position. It has been noted that higher rents worsen the unemployment trap (Social Security Select Committee 2000, Annex 2).

5.39 The poverty trap occurs when someone in low paid work is deterred from increasing their earnings by the high rate of withdrawal of means-tested benefits, such as Housing Benefit. The poverty trap is often the result of measures, such as Housing Benefit, of measures to tackle the unemployment trap. Housing Benefit has the potential to ease the unemployment trap (by supplementing low earnings), but at the cost of contributing to the poverty trap. This is still severe since the taper on the post 1988 system is 65 pence in the pound (of income after income tax and national insurance). The poverty trap worsens when HB withdrawal is combined with tax and the loss of other benefits. The Social Security Select Committee (2000, Annex 2, Table 1) provided hypothetical examples of the poverty trap at its worst, with a single person or a couple losing 90 pence of an additional £1 in gross earnings and a family losing 95 pence. The trap is worse for the family due to their declining entitlement to Working Families Tax Credit to which childless households were not entitled.

5.40 There are, again hypothetically, circumstances whereby the steep taper on HB may also contribute to the unemployment trap (if earnings are just too high for the claimant to qualify for HB).

Evidence

5.41 Although both work incentives and disincentives arising from HB can be demonstrated on paper, there is relatively little evidence to indicate its impact on *actual* behaviour. As Dilnot and Webb commented on the social security system generally, "there is remarkably little evidence that these incentive 'problems' cause any change in behaviour" (1988, pp. 52-3).

5.42 Limited evidence of the impact of Housing Benefit on the unemployment trap can be found in the study by Ford *et al.* (1996). The study found that "approximately half of all respondents made an economic calculation based on their outgoings and adhered to it when assessing employment opportunities. Just under a quarter made a similar calculation but then overrode it. Just over a quarter did not make any financial assessment of earnings in relation to outgoings" (ibid., p. 1). The authors stress the importance of households commitment to work, i.e. the work ethic, as something that may override purely financial calculations.

Upmarketing

5.43 In principle, the Housing Benefit system can also lead to an "upmarketing" problem. Recipients of social assistance have always received 100% of their eligible rent while everyone in the post 1988 system experiences a reduction of marginal housing costs to zero (i.e. if the rent rises by £1, so does HB, and vice versa), subject to the limitations to eligible rent discussed above.

5.44 Again, the evidence of the impact of HB on housing consumption is difficult to establish. It is presumably limited in the social rented sector where allocations are made administratively, although household composition often changes after allocation. Around 30 per cent of dwellings in the local authority sector were under-occupied in 1996 by one room and a further 15 per cent by two rooms. The use of the RSL stock was more efficient while the use of the owner occupied sector far less efficient (English House Condition Survey 1996, Table A3.1).

5.45 Reviewing the evidence just over a decade ago, Kemp (1992) concluded: "…although upmarketing may be a problem in theory it does not seem to be one in practice. Certainly, there is no research evidence to suggest that upmarketing is a significant problem" (p. 14). Since this analysis, additional measures to prevent it have been introduced.

Administrative costs and inadequacies

5.46 A recent Audit Commission report starts with the statement: "Housing Benefit is a service that many councils struggle to deliver well" (2002, p. 3).

5.47 Administrative problems have always been present in the Housing Benefit system, but it is only in the past ten years that administrative performance has become subject to official assessment and review. An Audit Commission report (1993) suggested that perhaps one-third of local authorities were failing to administer Housing Benefit properly. The 1993 report also suggested that the situation was particularly unsatisfactory in a significant minority of authorities where "large backlogs had developed causing a spiral of unopened mail, unprocessed claims and unanswered queries" (Audit Commission 2001, p.5).

5.48 The main focus of administrative performance has been on the speed and accuracy of claims, as well as the minimisation of fraud.

5.49 The Housing Benefit regulations place local authorities under an obligation to process claims (once relevant information has been collected) within 14 days. In 1994/95, 80% of claims were processed within 14 days, but by 2000/01 this had fallen to around 60-63%, even though the number of claims fell within this period (Audit Commission 2002, p. 5).

5.50 A National Audit Office report (1997) estimated that fraud and error cost between £900 million and £2 billion per year, which is equivalent to around 10-20% of the total costs (authors' calculation). A voluntary "verification framework" has been adopted by about 60% of local authorities to minimise fraud through the more rigorous checking of claimant details (Audit Commission 2001).

5.51 Performance varies between local authorities. The Audit Commission (2001) suggests that bigger and less stable populations in big metropolitan areas and in the London Boroughs may account for their generally inferior performance, but the quality of management and organisation might account for variations within groups of authorities.

5.52 Nevertheless, it is widely recognised that HB is inherently difficult to administer "due to the high volume of payments, the difficulty of keeping track of every person's circumstances and the opportunity for dishonest representations" (Audit Commission 2001, p. 5). Indeed some parties involved with Housing Benefit (including the Audit Commission and the National Audit Office) have concluded that the Housing Benefit scheme is too complex and is need of reform.

5.53 Although HB is difficult to administer, it is relatively cheap to administer. The most recent estimates of the costs of Housing Benefit administration are very similar to those experienced in the early 1990s. The cost of benefit administration is often reported in terms of administration as a proportion of expenditure. This gives an indication as to whether administrative costs are disproportionate to the gains – and on this test the message is clearly that HB represents good administrative value. HB administration represented 3.8% of benefit expenditure in 1991/92 and 3.3% in 1991/92 (DSS 1993, Figure 27; DWP 2002 Annex – key facts and figures). This ranks among the cheapest of all benefits (on 1991/92 figures): for example, the administrative costs of Income Support represented 12 per cent of expenditure. The main caveat is that only the local authority costs of HB administration are reflected in this figure.

5.54 But this is only one test of administrative cost, and it is one that will produce some possibly perverse results – e.g. as rents rise, so does the HB bill, and, *ceteris paribus*, its apparent efficiency. (Although one might note that wages, which are the most important component of administrative cost, reasonably rise with inflation, as do rents.)

5.55 The administrative cost per claim removes this potential distortion. On this measure the costs of HB administration appear to be acceptable. Data from 1991/92 indicates that the average weekly cost of the administration of each HB claim was £1.05. This was comparable with many other benefits and considerably less than for Income Support (£5.65) (DSS 1993, Figure 27).

Overall assessment

- Housing Benefit has become the largest single housing subsidy. It has been fundamental to the *transformation* of the housing system over the past 25 years, and arguably is required to *sustain* the new system.

- It appears to achieve, in general, its safety net and affordability objectives in the social rented sector. But in the private sector it is much less effective. Since additional cost control mechanisms were introduced in the mid-1990s, its performance in the private rented sector has deteriorated further. However, the HB system clearly (almost tautologically) achieved the objective of shifting subsidies away from bricks and mortar to personal subsidies.

- Although not discussed in any detail here, the role of HB in facilitating the private finance regime for RSLs, LSVTs and sustaining temporary and permanent tenancies under the homelessness legislation should not be overlooked.

- Although the HB system has been heavily criticised for its possible behavioural impacts (i.e. work disincentives and upmarketing), there is remarkably little evidence to substantiate these claims. Moreover, HB is relatively cheap to administer, although its administration is clearly difficult and some believe that it is too complex to administer well.

- The pros and cons of HB need to be considered next to its cost. HB is undoubtedly a large budget. HB cost £10 billion in England in 2001/02 (DWP 2002a). 43 per cent of this was accounted for by Rent Rebates and 57 per cent by Rent Allowances. The cost in England has been quite stable for the last few years, reflecting improved economic trends, as well as cost control measures in both social and market sectors (primarily of actual rents in the former and eligible rents in the latter). The evidence suggests that in terms of income distribution, HB is well targeted (Gibbs and Kemp 1993), despite the large proportions of social sector tenants who receive it (63% of social sector tenants and 25% of private sector tenants received HB in 2000/01– Context Paper, Table L3).

- This cost needs to be considered in the context of money saved by reducing bricks and mortar subsidies, as well as the nature of the social security system outlined above.

Conclusion: Housing Benefit and Current Objectives

5.56 The Government is dissatisfied with the operation of the current housing benefit system. Even so, its working assumption appears to be that the system should be reformed radically, rather than that the policy instrument should be abandoned altogether (DWP 2002).

5.57 The Government's criticism of the current HB system focuses on its:

- alleged impact on work incentives;

- administration; and

- alleged restriction of choice.

5.58 It is notable that the Government is now placing greater emphasis on work disincentives arising from administrative problems faced by people moving from unemployment into work, rather than on the high rate of benefit withdrawal as incomes rise. This limited perception of the work incentive issue indicates that relatively simple changes to the system can address the problem, e.g. by allowing people who move into work to have their benefit reassessed on the basis of a change in circumstance, rather than having to make a new claim (DWP 2002, p.5). The Government also believes that the administration of the system is improving and is capable of further improvements (ibid., p. 6).

5.59 More fundamental is the Government's view that the current system restricts choice – a variation on the upmarketing argument. In a series of pilots ("Pathfinders"), new private sector tenants will be given a flat rate housing allowance based on local market rents (as established by Local Reference Rents and Single Room Rents). This is intended to provide tenants with an incentive to occupy cheaper accommodation. The incentive is stronger than in the present system of Local Reference Rents and Single Room Rents, as these can only restrict eligible rent. The pilots will allow tenants to keep the difference if their actual rent is below the assessed rent. The Government aims to extend this system to the social rented sector, once rent restructuring has taken place.

5.60 Such quasi-market mechanisms place 'choice' above the safety net objective. However this objective has already been over-ridden by the cost control imperative in the private rented sector.

5.61 The 1988 HB system was an integral part of the social security system established at the same time. But it has not been well integrated into the new system of tax credits. The redistributive impact of the Working Tax Credit, as well as its (on paper) incentive for people to take relatively low-paid jobs, will be diminished by the loss of HB. As with Family Credit before it, every £1 of in-work benefit will lead to a reduction in HB entitlement of 65 pence. Yet the Government's concerns appear to focus on the administrative relationship between tax credits and HB (DWP 2002, p. 11, paragraph 2.8) rather than their important distributional and incentive effects. More radical plans for a housing tax credit have yet to be developed, but may be necessary if work incentives are to be enhanced.

6. Safety Nets for Owner Occupiers

Introduction

6.1 Both state and, more recently, market mechanisms have been called upon to act as safety nets for owner occupiers who find themselves become unable to meet their mortgage payments because of unexpected reductions in income (Pro-forma 12).

6.2 Owner-occupiers qualifying for social assistance benefits have been entitled to assistance with mortgage interest payments at least since the introduction of National Assistance in 1948. The practice has continued through the introduction of Supplementary Benefit in 1966, Income Support in 1988 and now income-related Jobseeker's Allowance.

6.3 The state safety net is now generally called ISMI (Income Support for Mortgage Interest). Since the introduction of ISMI in 1988, one major change has occurred. This was in 1995, when entitlement was restricted for most loans taken out after October 1995 – both in terms of when assistance could be claimed and in terms of the total loan covered. Also, since 1992 ISMI has generally been paid directly to the lender.

6.4 As with many social security benefits, the rules contain exceptions and contingencies that cannot be detailed fully here. For example, mortgagors aged over 60 are exempt from waiting periods, as are some lone parents.

Objectives

6.5 Given the long history of the scheme, there are no clear statements of its general objectives. As a part of the social assistance system, the instrument reflects the objective of preventing disposable income (in this case income after housing costs) falling below a minimum level. It thus performs more of a safety-net income maintenance function rather than a general housing safety net or affordability function, although these are intended and implicit consequences of the scheme.

6.6 The changes introduced in 1995 reflected more specific objectives:

- to place responsibility on the borrower to make provision for loss of income by taking out a private insurance policy, known as a Mortgage Payment Protection Insurance (MPPI)

- only once private provision had been exhausted should the borrower expect to receive support from the state.

6.7 More recently, these objectives have been confirmed in the Housing Green Paper (DETR/DSS 2000). The Green Paper set a target take-up rate for MPPI of 55% and suggested that the gap before ISMI is paid might be lengthened to 14 months. However, no further modifications to the scheme have been made to date.

6.8 The policy change of 1995 represented a significant change to what had been seen as a relatively minor policy whose cost had been rising rapidly as a result of recession but also in the context of poor risk assessment by lenders and borrowers alike as well as rising mortgage debt.

6.9 The policy change has had some adverse consequences (see below), but these have been limited by the economic cycle which has generated a benign economic environment (falling unemployment, rising employment, falling and low interest rates) and a buoyant housing market.

Evaluation

6.10 Evaluations of MPPI from the point of view of borrowers suggest:

- levels of take-up are quite low, but rose from 12-16% of mortgagors in 1995 to 19% in 1999 (Ford & Quilgars 2001). Since then take-up has continued to rise – to 23.7% in the first half of 2003 (CML data). Nevertheless, this falls well short of the Government's 55% target;

- take up among new advances is of course higher than for the whole stock. It rose from 72% in 1998 to 38.2% in the first half of 2003 (CML data);

- the risk profile of mortgagors with MPPI suggests that higher take up occurs among lower risk groups than higher risk groups (Holmans & Whitehead 1999);

- analyses of MPPI pricing suggest that it is expensive (Burchart & Hills 1997), but that block pricing causes lower risk households to subsidise higher risk households (Holmans & Whitehead 1999). Prices have fallen in recent years – from £5.60 per £100 monthly payment to £5.09 in the first half of 2003 (CML data);

- Ford & Quilgars 2001 found that around 20-33% of claims under MPPI policies were rejected. But by the first half of 2003 the rejection rate had fallen to 15% (CML data); and

- the transition between MPPI and ISMI leads to arrears in 12% of cases (Ford & Quilgars 2001.)

6.11 Evaluations of ISMI suggest:

- studies prior to the policy change in 1995 found that 2/3 of ISMI claimants did not receive full interest payments or had shortfalls, and the 20% of all ISMI claimants were in arrears (Ford & Wilcox 1992; Ford *et al.* 1995, cited in Ford & Quilgars 2001);

- the proportion of claimants who failed to meet payments during the gap period was actually lower among respondents with post 1995 mortgages than pre 1995 mortgages, although the proportions meeting all payments 'with difficulty' rose (ibid.);

- more than 80% of ISMI claimants experienced a shortfall in interest payments, the most common reason being an interest rate higher than the 'standard' rate introduced in 1995;

- around half of ISMI claimants fell into arrears at some point during the claim, this proportion being slightly higher among the post 1995 mortgagors (52% against 46%). (ibid.);

- Ford & Quilgars (2001) conclude that 'the evidence would seem to suggest strongly that the present safety net for low-income mortgagors us providing a largely ineffective support system' (p. 158).

6.12 In more quantitative terms the figures are as follows:

- ***Number of ISMI claimants***

6.13 The number of claims rose from 134,000 in 1980 to 356,000 in 1986 (when unemployment peaked). Claims then fell to 281,000 in 1988, before rising again, this time peaking at 555,000 in 1993. Again this reflects the rise in unemployment, although the peak is higher than the previous one. As unemployment has fallen, the number of claims also have fallen – to 260,000 in 2001, the lowest number since 1983 (Wilcox 2002, Table 107).

- ***Cost of ISMI***

6.14 The cost of ISMI rose from £71 million in 1980 to a peak of £1.2bn in 1993, coinciding with the peak number of claims, and also one of the highest amounts paid per claimant – reflecting high mortgage rates. The cost of the scheme fell very rapidly in 1996 (by 15%). But this cannot have simply reflected the more stringent qualification criteria as these only applied to borrowers with new mortgages. Falling claimant numbers and falling interest rates had a strong impact and costs fell continuously to less than £0.5bn. in 2001 (Wilcox 2002, Table 107).

- ***Arrears and possessions***

6.15 Clearly ISMI and MPPI do not prevent mortgage arrears and possessions from occurring. Possessions peaked at 75,540 in 1991, since when they have fallen continuously, but still 18,280 houses were taken into possession in 2001 (Wilcox 2002, Table 49).

- ***Impacts on lending behaviour***

6.16 These have not been studied with anything like the same care. However what evidence there is would suggest that it has had little direct impact and has increased fees and therefore measured profitability.

Conclusions

6.17 Any negative impacts of the 1995 changes have been offset over the period analysed by a very benign environment of falling unemployment, growing employment, rising incomes, mortgage interest rates that have fallen to historically low levels, and a buoyant housing market in most parts of the country. The 'new' (post 1995) system will be tested much more strongly – as will lenders and borrowers wider evaluations of risk were the macro economy to go into recession.

6.18 It should be remembered that most evaluations focus on the post 1995 system and on the change that occurred then. Clearly, the safety net over the whole period has failed to prevent thousands of people losing their homes. Equally many households had made unsustainable decisions. But no evaluation attempts to estimate the numbers of people whose homes have been saved by ISMI/MPPI.

7. Overview and Conclusions

Sequential Overview

The 1970s

7.1 The 1970s could be described as a firefighting decade. It was about policies that did not happen, rather than about those that did (e.g. rent restructuring) – except for LA and HA supply subsidy frameworks. Equally it was about policies outside housing rather than policies responding specifically to housing problems/opportunities. The control of LA powers arose as part of the general response to the International Monetary Fund's requirements and led on to HIPs; rent control in the LA sector arose from incomes policy. Equally local authorities developed responses to their own concerns: municipalisation, restricted by central government; the use of the Right to Sell; the Birmingham 50:50 and other low cost home ownership schemes.

7.2 Affordability was mainly determined by luck/access. Those in the system – i.e. in local authority or owner-occupied housing – were well protected, although by different means in the different sectors and sub-sectors. Those excluded suffered high costs and poor housing. The income related benefits put in place were generous and helped large numbers of those in work as well as those outside the labour force. However only low rents made them affordable to government. The earlier transfer of benefits from the Department of the Environment to the Department of Social Security was – and remains – important in determining longer term policy. Overall it could be said to have been housing policy at the behest of macro policy. Even so, some valuable frameworks for future initiatives were put in place.

The 1980s

7.3 The 1980s were basically about decreasing public expenditure and increasing rents in the social sector via changing financial constraints. They were also about deregulation and privatisation more widely. The impact of these polices on affordability was dependent on the mix of households accommodated in each sector, income growth and the extent of housing benefit.

7.4 The transfer of households to owner-occupation with large discounts through the Right to Buy helped ensure affordable homeownership for large numbers of households. Other low cost homeownership policies were not particularly successful – they were small scale and difficult to comprehend.

7.5 The removal of the special circuit of mortgage finance initially led to some increased interest rates and higher costs to owner-occupiers. However competition in the mortgage market resulted in interest rates being structurally 'reduced' against the background of volatile general interest rates.

7.6 The shift between local authority sector and owner-occupation – affordability through capital value discounts rather than direct funding – did not in general generate problems of affordability – even in the recession of the late 1990s. Specific problems were associated with high-rise flats and difficulties in estimating and funding improvement expenditure as well as in some areas of low demand. Those who otherwise would have been in the social sector without these policy shifts, who mainly went straight into owner-occupation, ended up paying more but obtaining greater choice – and the tenure to which they aspired. Some of these households faced significant problems associated with the risks associated with the late 1980s recession. Throughout most of the decade much of the private rented sector remained subject to control and the size of the flexible market declined. Access problems for those not able to afford owner-occupation or achieve social renting remained unchanged.

7.7 The 1988 Housing Act was crucial to the organisation in the financing and regulation of the rented sector, involving the changing structure of private rented sector; private finance for Housing Associations; and, at least initially increased rents. However benefits – both in terms of a more flexible private rented sector and in funding and reorganizing social housing took time to become apparent.

The 1990s

7.8 In many ways the 1990s were simply about more of the same – except that in the main the economic environment was benign, allowing greater targeting, more effective transfers of risk and some increases in housing costs without generating affordability problems.

7.9 However the early part of the decade saw the greatest threat to affordability and sustainability ever faced by owner-occupation, putting well over a million households into negative equity and unprecedented numbers into arrears and the loss of their home. These problems were addressed without specific housing polices and were overcome, at least in the short run, by improvements in the economy.

7.10 Affordability among owner-occupiers has been significantly improved in spite of the removal of mortgage tax relief by broader economic change. The current concerns relate to entry costs for first time buyers; the extent to which low inflation means that high entry costs remain into the longer term; and exposure to interest rate risk – together with the possibility of large scale declines in house prices especially if the economy goes into major recession; as well as the impact of housing on the wider economy. These issues have not been addressed at a fundamental level – in part because of the successful outcome of the earlier crisis.

7.11 Policies with respect to the social sector have been implemented in a fairly consistent fashion – except for the volatility in financing of the ADP. Local authorities continue to have few options except transfer – and though the immediate popularity of ALMOs reflects the continued tensions. The most important development in policy has been in the capacity to transfer low/negative valued property. The market value of these risks has been high in terms of interest rate costs and the extent to which these risks have been correctly evaluated is unclear.

7.12 Housing association finances were successfully supported by rent increases in the early 1990s and further assisted by the decline in ADP in the later part of the decade which reduced their building programmes. The sector's position remains exposed to changes in government expenditure priorities.

7.13 Rent restructuring increases pressures for organisational change and, perhaps, for reducing costs (the first real attempt to introduce incentives to reduce costs outside new investment). However the basis for setting rents is not consistent with trends in either costs or consumer preferences.

7.14 In the main the private rented sector has developed in its own way since deregulation – manifested mainly in changes in who is housed rather than in investment in additional stock. The scale of easy access flexible accommodation has increased by at least 300%. However the sector still remains dependent on capital gains on the one hand and housing benefit on the other for its sustainability.

Conclusions

General focus

7.15 The thrust of housing finance policy has been more a response to external pressures than a pro-active attempt to achieve specific housing goals. A fundamental in this relationship has been the impact of unexpected inflation and changes in the rate of inflation on financial viability on the one hand and the opportunities for asset restructuring on the other. Equally, expected inflation has impacted on interest rates and costs, while variations in employment and economic growth have helped determine both the extent of demand and the level of government commitment.

7.16 General deregulation of finance markets, together with the need for public expenditure constraints, and the requirement to improve efficiency in the public sector have generally been far more important in determining the changes in financial regimes than housing specific objectives.

7.17 Even so, the large scale shifts in policy have been accomplished without worsening average affordability (tables 7.1 and 7.2). However many households in the private rented sector still face unacceptable problems, while those entering the owner-occupied sector in pressured areas often take on costs and risks which may prove extremely difficult to manage in a different macro environment. Equally statistics cannot capture those who are excluded by affordability problems.

Table 7.1: **Net Rent and Mortgage Payment as Percent of Disposable Income of Head of House and Spouse: 1989 Great Britain**

Rented from Council	**Mean**
Under £3,000	5
£3,000-£3,999	9
£4,000-£5,999	10
£6,000-£7,999	12
£8,000-£9,999	11
£10,000-£11,999	11
£12,000-£14,999	9
£15,000 and over	7
Total	**9**
Housing Association	
Under £4,000	9
£4,000 and over	11
Total	**11**
Private rented, unfurnished	
Under £4,000	14
£4,000 – £7,999	20
£8,000 and over	8
Total	**12**
Private rented, furnished	
Under £4,000	54
£4,000 – £7,999	30
£8,000 and over	17
Total	**25**
Mortgage payments (net of tax relief)	
Under £4,000	81
£4,000 – £5,999	31
£6,000 – £7,999	28
£8,000 – £9,999	24
£10,000 – £11,999	20
£12,000 – £14,999	20
£15,000 – £19,999	17
£20,000 and over	15
Total	**18**

Source: *Housing and Construction Statistics 1980-1990*, Tables 12.9 and 12.10 Original Source in Family Expenditure Survey

Table 7.2: **Ratio of Mean Net Rent or Mortgage Payments to Mean Disposable of Household Head and Partner: 1999/00 England (percent)**

Income (£ per week)	Rented from Council	Rented from RSL	Rented Privately	Owner-occupiers with mortgage
Under £100, Under £5,200	10	16	64	36
£100-£199 £5200-£10,399	11	13	31	36
£200-£299 £10,400-£15,599	12	14	29	21
£300-£399 £15,600-£20,799	12	16	26	18
£400-£499 £20,800-£25,599	7	13	21	15
£500-£599 £26,000-£30,199	7	13	21	15
£600-£699 £32,000-£35,399	7	13	21	15
£700 and over £36,300 and over	7	13	21	15
All Incomes (%)	**11**	**14**	**26**	**15**

Source: *Housing Statistics 2001*, Tables 7.13 and 7.14. Original source is the Family Resources Survey

7.18 Where the system has clearly failed is in providing adequate incentives and financial support to maintain output in the social sector or to enable private sector new housebuilding programmes to fill the gap. Equally the incentives to maintain and improve the stock across tenures have been poor and the reduction in grants and loans to the private sector makes it more difficult to implement current policies with respect to decent homes.

Sector by sector assessment

7.19 There have been a number of affordability crises in the owner-occupied sector associated with inflation and unemployment together with volatility in house prices. Structurally declines in money interest rates and access to relatively competitive mortgage markets together with entry subsidies has improved average affordability – and has provided very high returns for some. However there are significant remaining risks – some of which are part of current debate.

7.20 In terms of specific policies with respect to the private sector, on its own terms the removal of mortgage tax relief was a great success – but mainly because of the benign economic environment. Liberalisation of the housing finance market was a necessary part of more general deregulation (and itself made the removal of mortgage tax relief more important – see the problems in the US where that reform was not undertaken). It has in many ways been highly successful – but has generated its own risks, not all of which have been correctly evaluated by those affected.

7.21 Deregulation of the private rented sector has also operated remarkably well in its own terms generating a very much larger and different market in easy access housing. However the sector is still basically supported by HB and capital gains, neither of which can be expected to continue into the future – at least at current levels. Quality and value for money is often poor and there is little security for those looking for longer term solutions. Institutional investment has not yet become an important part of the market so ownership remains in the hands of small landlords many of whom may exit if circumstances change.

7.22 Restructuring social sector housing finance was also significantly an outcome of economic factors together with the general political commitment to privatisation and increased efficiency. The process has if anything increased rather than reduced aspects of regulation, currently reflected in the re-introduction of rent controls with respect to individual properties.

7.23 Again in their own terms the policies have been fairly successful – although they have led to further problems. The changes in the position of local authorities have been extremely constraining which has impacted adversely on management, repairs and maintenance. Government has responded by seeking to separate strategy from the allocation and management of the stock. Evidence on how costs have been allocated and the cost effectiveness of the process is only now beginning to emerge. It does seem that large implicit subsidies have been required to make the restructuring process work – although this has not been reflected in further affordability problems for the majority particularly because they have been insulated by Housing Benefit.

7.24 The financial regime for housing associations has also worked well, although not necessarily at least cost. There have been problems with respect to the quality and location of some new units but in financial terms the sector is robust. The main problem here is the continued dependence on volatile government funding allocations. This can result in very large changes in the programme – both in total and in type – at short notice, almost certainly generating less effective outcomes.

7.25 Changes to social housing supply side subsidies have culminated in the evolution of a relatively efficient and durable funding model for housing associations, now closely tied into a wider business and private financial context. Council housing on the other hand started as a financial framework for building homes before shifting into a control mechanism with which central government could influence rents and capital funding levels and then shifting on to asset management issues that seek to separate the strategic focus from operational control through a range of provision models.

7.26 There has been surprisingly little pressure throughout the period to cut the resource cost of provision. This is beginning to change, as at least in the RSL sector (and more recently in the council sector) long term on-going costs are now being addressed through major repairs allowances (council) and sinking fund provision (RSLs).

7.27 Affordability has been challenged as a result of both supply and demand changes throughout the period of the evaluation. Reductions in revenue subsidies and increased incentives to raise the share of private funding have tended to push average rents up. At the same time, the demographics of social housing's client group (itself partly

endogenous to policy decisions) has allowed Housing Benefit eligibility to take up more and more of the cost of increasing rents – until it was recognised that this was unsustainable and led to downward pressure on average rents.

7.28 The main policy that has not been successful in its own terms is Housing Benefit. It is clear that its structure needs reform and its organisation has been a mess – but it has proved extremely difficult to address these issues without other changes – notably to the general welfare system – which are only now being put in place. The new pilots are over-complex in administrative terms but have the potential to provide a framework for reform. More fundamentally housing benefit has supported all the rented sectors effectively and ensured affordability for most of those at the bottom of the system. The major problems of affordability continue to be among lower income employed households and among particularly single people who face costs of living which are inadequately reflected in benefit levels.

Overview

7.29 Thus, returning to our original typology, the period 1975 to 2001 has seen:

- considerable market building in terms of housing finance markets, insurance and the development (or rather re-development) of the private rented sector;

- this has been closely associated with deregulation of both finance and housing markets. However in the social sector and in terms of demand side subsidies there has, if anything, been an increase in regulation although the nature of that regulation has changed significantly and is more in line with efficiency objectives;

- taxation has been increased, reliefs and general subsidies reduced – leading to significant declines in public expenditure. The shift from supply to demand subsidies has been obtained without very large scale increases in problems of affordability because of the benign macro-economic environment – but no part of the system is robust to changes in that economic environment;

- direct involvement by government in provision has been very significantly reduced in part with the help of directed subsidies such as the Right to Buy and more generally by regulation and direct controls on local authority powers.

7.30 Overall therefore the picture is one of incremental change, tenure (and sub-tenure) by tenure, rather than a coherent package of reform – as envisaged at the time of the Housing Policy Review. Many problems have been successfully addressed and the restructuring of the social sector is well underway. However there is no certainty that housing finance – either private or public – is fully robust or that affordability is guaranteed. Equally there is considerable evidence that changes have been obtained at considerable cost – even though this has mostly been absorbed by the use of unrealised implicit capital gains. There is thus now far less slack in the system than there was during much of the evaluation period and the next round of reforms may therefore be more difficult to achieve.

7.31 What is perhaps most notable about this report is how housing specific it is. There is almost nothing about regeneration or area specific policies. Nor is housing seen as an element in social infrastructure. This is because the objectives at the beginning of the period were to ensure a good quality roof over everyone's head at an acceptable cost to government and household alike. This objective has been achieved for the vast majority of the population, even though the position of certain groups may have worsened in relative terms. The Agenda has now moved on and the definition of housing has been broadened to include environment, safety and security and local services as well as the physical fabric of the area. This is only now beginning to be reflected in specific housing policies. The next evaluation will undoubtedly concentrate on success and failure in this procedure context.

References

Andrew, M. Evans, A., Koundouri, P. and Meen, G. (2003) *Residential stamp duty – time for a change,* Council of Mortgage Lenders: London

Audit Commission (1993) *Remote Control: the National Administration of Housing Benefit*, London: HMSO

– (2001) *Learning from Inspection: Housing Benefit Administration*, London: Audit Commission

– (2002) *Housing Benefit: the national perspective*, London: Audit Commission

– (2002) *Housing after Transfer: The Local Authority Role*. www.audit-commisssion.gov.uk. Accessed August 11 2003

Barker, K. (2003) *Review of Housing Supply,* Interim Report, HMSO, London

Barker K. (2004) *Review of Housing Supply*, Final Report – Recommendations, HMSO, London

Best, R. (ed) (1980) *Inquiry into British Housing and Papers*, Joseph Rowntree Foundation, York

Best, R. (ed) (2002) *Inquiry into British Housing, What Has Happened Since?* Joseph Rowntree Foundation, York

Boleat, M. (1982) *The Building Society Industry,* Allen & Unwin, London

Boleat, M. & Coles, A. (1987) *The Mortgage Market: Theory and Practice of Housing Finance*, Allen & Unwin, London

Boleat, M. (1994) 'The 1985 – 2993 Housing Market in the UK: An Overview', *Housing Policy Debate*, Vol 5, Issue 3

Buckley R. & Ermisch J. (1982) 'Government Policy and House Prices in the United Kingdom: An Econometric Analysis' *Oxford Bulletin of Economics and Statistics*, 44(4)

Caplin, A., Joye, C., Glaeser, E., Butt, P. & Kuczynski, M. (2003) *New Approaches to Reducing the Costs of Home Ownership,* A Report for the Prime Minister's Home Ownership Taskforce, Draft report, mimeo

Caplin, A., Chan, S., Freeman, C. and Tracy, J (1991) *Housing Partnerships: a New Approach to a Market at a Crossroads*, MIT Press, Cambridge

Chaplin, R., Jones, M., Martin, S., Pryke, M., Royce, C., Saw, P., Whitehead, C., & Yang, J., (1995) *Rents and Risks*, Joseph Rowntree Foundation, York

Council of Mortgage Lenders (2003) *Take-up of Mortgage Payment Protection Insurance/ Sustainable Home-ownership Target*, Statistics page, 18 March, cml.org.uk

Crook, A., Kemp, P., Anderson, I and Bowman, S. (1991) *The Business Expansion Scheme and Rented Housing*, Joseph Rowntree Foundation, York

Crook, A. (1995) *The Supply of Privately Rented Homes: Today and Tomorrow,* Joseph Rowntree Foundation, York

Crook, A. & Kemp, P. (1999) *Financial Institutions and Private Rented Housing,* Joseph Rowntree Foundation, York

Department of the Environment (1971) *Fair Deal for Housing*, Cmnd. 4728, London: HMSO

Department of Environment (1977) *Housing Policy: a Consultation Document,* Cmnd 6551, HMSO

Department of the Environment (1979) *Housing & Construction Statistics*, No. 32, Quarter 4, London: HMSO

Department of the Environment (1987) *Housing: the Government's Proposals*, Cmnd 214, HMSO, London

Department of the Environment (1988) *Local Government in England and Wales: Capital Expenditure and Finance,* Consultation Paper, Department of the Environment, London

Department of Environment, Transport and the Regions/ Department of Social Security (2000) *Quality & Choice: A Decent Home for All: The Housing Green Paper*, London: DETR/DSS

Department of the Environment, Transport and the Regions (2000) *Quality and Choice: A decent home for all* (The Housing Green Paper), London: DETR

Department of Environment, Transport and the Regions (1997) An Econometric Model of the Demand and Need for Social Housing, London, DETR.

Department of Social Security (1993?) *The Government's Expenditure Plans 1993-94-1995-96*, Cm 2213, London; HMSO

Department of Work and Pensions (DWP) (2002) *Building Choice and Responsibility: a radical agenda for housing benefit*, London; DWP

– (2002a) Housing Benefit & Council Tax Benefit Annual Summary Statistics, May, www.dwp.gov.uk

– (2003) *Income Related Benefits; Estimates of Take-Up in 2000/2001*, London

Diamond M. & Lee, D. (1992) 'Housing Finance in Developed Countries', *Journal of Housing Research*, Vol. 3 Issue 1

Dilnot, A. and Webb, S. (1988) 'The 1988 Social Security reforms', *Fiscal Studies*, Vol. 9, No. 3, pp. 26-53

Ford, J., England, J. and Kempson, E. (1996) 'Housing Costs, Housing Benefits and Work Disincentives', *Findings*, Housing Research No. 185, July

Ford, J. and Quilgars, D. (2001) 'Failing Home Owners? The Effectiveness of Public and Private Safety-nets', *Housing Studies*, Vol. 16, No. 2, pp. 147-162

Ford, J. and Wilcox, S. (1992) *Evaluating the Initiatives: Mortgage Arrears and Possession*, York: JRF

Ford, J., Kempson, E. and Wilson, M. (1995) *Mortgage Arrears and Possessions: Perspectives from Lenders, Borrowers and the Courts*, London; HMSO

Freeman, A., Holmans, A., & Whitehead, C., (1996) *Is the UK Different? International Comparisons of Tenure Patterns*, Council of Mortgage Lenders, London

Gibb, K. and Maclennan, D. (2003) *The Process and Effects of Stock Transfer Programmes: A Literature Review for the Welsh Assembly Government.* University of Glasgow, Department of Urban Studies

Gibbs, I. and Kemp, P. (1993) 'Housing Benefit and Income redistribution', *Urban Studies*, Vol. 30, No. 1, pp. 63-72

Grey, A. & Hepworth, N.P. & Odling Smee, J. (1981) *Housing Rents, Costs and Subsidies*, CIPFA, London

Hancock, K. (1993) "Can't Pay? Won't Pay? or Economic Principles of Affordability" in *Urban Studies*, Volume 3, No 3, pp127-145

Hills, J. (1990) *Unravelling Housing Finance*: *Subsidies, Benefits and Taxation,* Clarendon Press: Oxford

Hills, J., Hubert, F., Truman, H & Whitehead, C. (1990) 'Shifting subsidies from bricks and mortar to people: Expenses in Britain and West Germany' *Housing Studies*, Volume 5 No. 3

Holmans, A. and Whitehead, C. (1988) *Housing Subsidies and Tax Reliefs for British Households*, Council of Mortgage Lenders: London

Holmans, A. and Whitehead, C. (1998a) *Funding Affordable Social Housing*, National Housing Federation: London

Holmans, A. and Whitehead, C. (1999) 'Who should buy MPPI?', *Housing Finance*, Vol. 42, May, pp. 22-27

Holmans, A., Scanlon, K. & Whitehead, C. (2002) *Fiscal Policy Instruments to Promote Affordable Housing*, Research Report VII, Cambridge Centre for Housing and Planning Research, Cambridge

Holmans, A., Karley, K. & Whitehead, C. (2003) *Prospects for Mortgage Backed Securities in the UK: a Review of the Evidence*, Council of Mortgage Lenders, London

Holmans, A., Monk, S. & Whitehead, C. (2004) *Building for the Future, 2004 Update*, London, Shelter

House of Commons Social Security Committee (2000) *Sixth Report: Housing Benefit*, London: The Stationery Office

Hughes, G. (1987) *Rates Reform and the Housing Market* University of Edinburgh, Department of Economics Discussion Paper IV

Karn, V. Kenemy, J. & Williams, P. (1985) *Home Ownership in the Inner City*

Kemp, P. (1992) *Housing Benefit and appraisal*, London: Social Security Advisory Committee

Kemp (2000) 'The role and design on income-related housing allowances', *International Social Security Review*, Vol. 53, No. 3, pp. 43-57

Kemp, P. and Wilcox, S. (2002) 'Reforming Housing Benefit for private tenants and tax credit recipients', *Findings*, April, Ref 462

Kemp, P. Wilcox, S. and Rhodes, D. (2002) *Housing Benefit reform: the next steps*: York: York Publishing Services

Kemp, P. and Pryce, G. (2002) *Evaluating the Mortgage Safety Net*, London: Council of Mortgage Lenders

Kemp, P. and Rugg, J. (1998) *The Single Room Rent: Its impact on young people*, Centre for Housing Policy, University of York

Kempson, E. (1999) 'Unsafe Safety Nets? How Effective are MPPI and ISMI', *Housing Finance*, Vol. 42, May, pp.28-35

Kiddle, C. (2002) 'The impact of the large scale voluntary transfer of local authority housing stock on the HA sector', Sector Study 17. The Housing Corporation: London.

Kleinman, M. and Whitehead, C. (1988) "British housing since 1979, Has the system changed?" *Housing Studies*, Vol 3 No 1, pp 3-19

Lomas, G. (1980) "Improving Mr Bailey's Home: personal choice and national interest", *CES Review*, No 9

Meen, G.P., (1990) The removal of mortgage market constraints and the implications for econometric modelling of UK house prices, *Oxford Bulletin of Economics and Statistics*, Volume 52, 1-24

Meen G.P. (1996) Ten Propositions in UK housing macro-economics: an overview of the eighties and early nineties, *Urban Studies,* 33, 425-44

Miles, D. (2003) *The UK Mortgage Market: Taking a Longer-Term View*, Interim Report, Information, Incentives, Pricing, HM Treasury, HMSO, London

National Audit Office (1997)

National Audit Office (2003) *Improving Social Housing Through Transfer*. NAO: London

Nuttall, S., "Household borrowing: impact of interest rate rises", *Housing Finance*, No 61, Spring 2004, Council of Mortgage Lenders, London

Rhodes, D. & Bevan, M. (2003), *Private landlords and buy to let*, Centre for Housing Policy Research Report, University of York

Saw, P. & Whitehead, C. (1997) 'Financing Social Housing without guarantee: an English case study' *Netherlands Journal of Housing and the Built Environment*, Volume 12, pp. 423-443

Scanlon, K. & Whitehead, C., (forthcoming) title

Stephens, M. (1990) 'Students and Social Security Benefits', *Journal of Education Policy*

Stephens, M., Burns, N. and McKay, L. (2002) *Social Market or Safety Net? British Social Rented Housing in a European Context*, Bristol: Policy Press

Warburton, M. (1991) *What Price Council Housing*, London, National Consumer Council

Webster, D. (1977) 'How One Subsidy System Works: The 1975 Act System', *CES Review,* No 2, December

Whitehead, C.M.E. (1979) 'What should be done with the Guideline?', *CES Review,* No 7, September

Whitehead, C.M.E. (1978) 'The £25,000 Limit', *CES Review* 4, September

Whitehead, C.M.E. (1981) 'Housing Finance: a changing market', *Public Money,* Volume 1 No 1

Whitehead, C.M.E. (1983) 'More Controls?' *Public Money,* Volume 3 No 3

Whitehead, C.M.E. (1989) *Housing Finance in the UK in the 1980s*, STICERD Welfare State Programme Research Note No 20, London STICERD, LSE

Whitehead, C.M.E. (1989) "Rental Housing: Radical Restructuring" *Public Money and Management*, Volume 9 No 1

Whitehead, C.M.E. (1991) 'From Needs to Affordability' *Urban Studies*, Vol 28, No 6

Whitehead, C.M.E. (ed) (1994) *The Private Rented Sector*, mimeo, London, LSE Housing

Whitehead,C.M.E. (1994) 'Privatising Housing, An Assessment of UK Experience', *Housing Policy Debate*, Vol 4, No 1

Whitehead, C.M.E. (1998) 'Economic Flexibility and the Private Rented Sector' *Scottish Journal of Political Economy*, Vol 45, No. 4

Whitehead C.M.E. (1999) "The Provision of Finance for Social Housing: a UK Experience", *Urban Studies*, Vol 36, No 4

Whitehead, C. and Kleinman, M. (1989) "The Viability of the Privately Rented Housing Market" in Ermisch, J., *Housing and the National Economy*, Gower: Aldershot, Hants

Whitehead, C. and Kleinman, M. (1996) *The Private Rented Sector*, London: National Housing Federation

Whitehead C. & Kleinman M. (1987) Private Rented Housing in the 1980s and 19990s, Cambridge, Granta Editions

Wilcox, S. & Williams, P. (2001) 'Funding Social Housing: Changing Times, Changing Markets', *Housing Finance*, 52, pp. 38-45

Wilcox, S. (2002) *Housing Review 2002/2003*, Joseph Rowntree Foundation, Chartered Institute of Housing, Council of Mortgage Lenders: York

Wilson, H. (1977) *Committee to Review the Functions of Financial Institutions*

Witherspoon, S. Whyley, C. and Kempson, E. (1995) *Paying for Rented Housing: Non-Dependant Deductions from Housing Benefit*, DSS Research Summary, No.2, London; DSS

This report is one of five theme reports produced as part of the Evaluation of English Policy. It considers the extent to which policy through the period has addressed the issues of finance and affordability of housing.