Incentives in the social rented sector: principles and outcomes

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Overall aims of housing policy

- **"A decent home for all at a price within their means"**
- Both housing (decent) and income distribution (affordability) aims
- Traditionally met in a variety of ways:
- Cash (Income Support, tax credits, etc)
- Grants, soft loans, etc
- Regulation (building regulations, rent control, security of tenure, etc)
- Tied cash (Housing Benefit, tax concessions related to housing spending)
- Supply of housing at below market rent

In cash flow terms, the last 25 years saw a major shift towards demand subsides through Housing Benefit (£billion, 2003-04 prices)

	75-76	80-81	85-86	92-93	99-00	03-04
Capital grants	10.7	6.3	5.2	5.8	3.0	5.2
LA revenue	3.3	4.3	1.8	0.6	-1.0	0.2
Total supply	**14.0**	**10.6**	**7.0**	**6.4**	**2.0**	**5.4**
HB: LA tenants	0.6	0.7	4.4	5.0	4.7	4.1
HB: PRS/HAs	0.1	0.1	1.7	4.0	5.5	6.3
Mortgage tax relief	2.4	4.6	7.8	6.1	1.9	0
IS for mortgage interest	Na	Na	Na	1.5	0.6	0.3
Total demand	**3.1**	**5.4**	**13.9**	**16.6**	**12.7**	**10.7**
Total	**17.1**	**15.9**	**20.9**	**23.0**	**14.7**	**16.1**

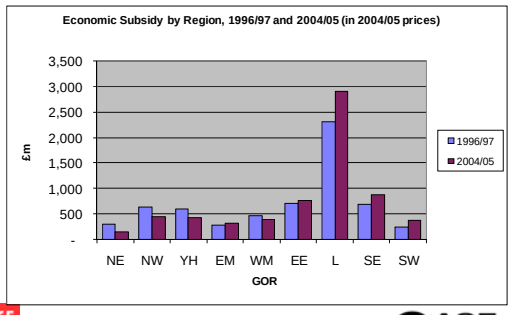
But cash flow subsidies and economic subsidy are not the same thing…

- Cash flow subsidies measure the financial flows from government to providers to help them balance their books. Some of their costs may be very high when a property is first built, and debt charges are at their highest in real terms. For a dwelling built many years ago, the debt charges in the financial accounts may be very small.
- But in economic terms, what will matter will be the difference between the value of the resources being used and the amount being paid (for the provider) or the difference between how much someone would have to pay to get something equivalent elsewhere and the amount paid (from the tenant's point of view).
- One way of getting at "economic subsidy" is to compare actual rents with what would be needed to give a return on the capital value of a property (net of running costs) equivalent to that gained by private landlords.

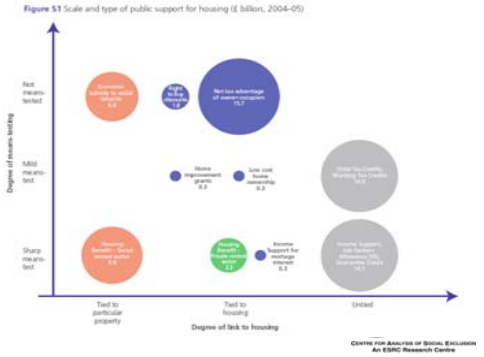
Values of economic subsidy to council tenants vary substantially by region, 2004

	Capital value (£000s)	Economic rent (£/w)	Actual rent (£/w)	Economic subsidy (£/w)
North East	58.6	55	43	11
North West	65.1	65	47	17
Yorks &	62.2	65	44	20
E Midlands	77.7	67	46	21
W Midlands	73.9	67	49	17
East	128.2	101	55	46
London	165.2	138	67	71
South East	128.0	98	59	38
South West	100.8	76	50	26
Total	**100.7**	**87**	**53**	**34**

So most subsidy in economic terms is concentrated in London and the East



In overall economic terms, tax advantages of owners and sub-market rents for social tenants remain important



The way we provide subsidies affects decisions

- By providers:
  - To provide more units and buy or sell particular kinds of property
  - To refurbish or build new
  - To control costs
  - To charge particular levels of rent
  - To maintain/repair to particular standards
  - To respond to tenant preferences/dissatisfaction
- By government:
  - To invest in particular ways because of either long-run economic costs or (often) short-term cash flow differences
- By tenants/potential tenants:
  - To queue for entry (and to form households or stay with parents)
  - To remain as tenants/ move to different kinds of property
  - To seek work or increase hours

Incentives for providers (1)

- Subsidy allows provider to bridge gap between costs and rents, so can increase supply, even if rents don't give high enough return.
- But systems which bridge gap between actual costs and externally set rents can remove incentive for provider to control costs.
- For instance, when local authorities are allowed to build, the loan charges which result are added to the spending on which they are allowed to claim recurrent subsidy: an extra £1 of loan charges could mean an extra £1 of subsidy, undermining pressures to control costs (except for overall limits on borrowing).
- Housing associations have been supported by capital grants. In 1980s, these reduced the amount the association had to borrow to the level it could cover out of externally set rents – again £1 of higher costs, meant £1 more capital grant.
- By the 1990s this was changed so that grant became fixed – any extra spending would mean more cost for the association; lower spending would reduce its overall costs – it carries the risks.

Incentives for providers (2)

- When running property, a key issue is how to deal with depreciation or the eventual need for major repair or renewal. Local authority subsidy systems have left the cost of this to (potential) later subsidy– this may undermine incentives to build with "lifetime costs" in mind.
- By contrast, housing association grant systems have left later major repairs to the association and so strong incentives (but also risks) to get it right from the start.
- Similarly, revenue subsidies that make up deficits can remove incentives to control recurrent costs on things such as management and maintenance – this is less usual, as usually subsidy systems are based on fixed "allowances" for recurrent spending – it's up to the landlord whether to spend at that level or another.
- In the other direction, systems that claw back actual "surpluses" from landlords may reduce incentives to control costs or to charge higher rents – the benefit accrues to government, not the landlord.

Incentives for providers (3)

- In a competitive market, a landlord would judge the level of rent and standard of service combination that gave the best return, adjusting the two if prospective tenants were more attracted by lower rents or higher standards.
- But with rents set externally, landlords have little choice – for a non-profit landlord, they may have little reason to spend anything other than the fixed allowance.
- A particular current issue is energy efficiency: eg insulation may partly "pay for itself", so higher rents would be offset by lower heating bills. But if rents are controlled, landlords can't do this.
- In a rationed market, tenants could lose a lot by taking their business elsewhere: the net present value of a social tenancy may be up to £70,000 or more in London – if a tenant moves out, they can't take that with them. As a result, some providers may not respond to tenant preferences or dissatisfaction. Without "exit" power, we need systems so that landlords respond to tenant "voice".

Incentives for government

- The more that government sees itself as offering a potential "blank cheque" or "one-way bet", the more that it will see the need for administrative controls and regulation. So if it pays the marginal cost of higher capital costs, it will want to control standards. If it pays (through Housing Benefit) for most tenants' rents at the margin, it will want to control rents…
- Differential subsidy systems may push it one way or another. A government wanting to reduce its long run risk/responsibilities may favour a system based on initial capital grants and no later connection – "fund and forget". One most concerned about immediate cash flow might prefer to pay recurrent subsidies over the long-term than an up front initial grant (but not if all capital spending counts as "public spending", which it is trying to control….).

Incentives for tenants (1)

- In a competitive market, a tenant would choose between properties on the basis of the combination of location, rent and standard of service. But subsidy systems affect this in two ways.
- First, if some (social) landlords offer sub-market rents, tenants may want to gain access because of the low price, even if the relationship between cost and quality is not that good. If there are limits to available units, queues will build up – these will be bigger, the deeper the economic subsidy.
- There may be substantial excess demand for subsidised housing even if prospective tenants wouldn't value gaining access as highly as the subsidy/grant required to provide it.
- Rationing systems may also give incentives – or apparent incentives – for people to cheat or exaggerate their needs (or indeed to leave themselves in a position where they are "in need").

Incentives for tenants (2)

- Second, Housing Benefit systems may leave tenants indifferent to the level of gross rent. In the UK system for social tenants, if a tenant receives HB, a £1 higher rent would mean £1 more in benefit. The same used to be true of private tenants, leading to worries about "upmarketing" (or more likely, not down-marketing..) – occupying more valuable property than they would choose left to themselves (although remember – this may in part be the reason for subsidy…). In the new "local housing allowance" system for private tenants, HB is based on fixed rents, so tenants in cheaper property make a saving (up to a limit) to try to avoid this problem.
- Housing allowances may also affect the energy efficiency decision: in the UK, higher rents may be met by HB (ie government), while the benefit of lower heating bills go to the tenant (which don't affect benefits) – so tenants may want it, but not DWP…. In other countries, housing allowances may be based on rents including heating costs, so the effect would be different.

Incentives for tenants (3)

- Rent structures also matter: in the system that has emerged in England social rent structures have become very "flat" both between and within areas – the rent for a larger property in a more sought-after area may not be much higher than that for a small one in a less desirable area. As a result, demand rises for the more desirable properties and falls for the least desirable ones. Older tenants gain little (except disruption) if they move to smaller property when children leave home.

So subsidised systems create significant costs:

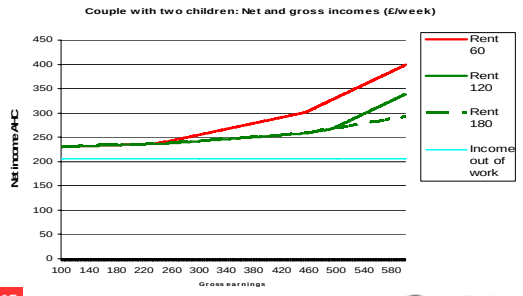
- Unless designed very carefully, incentives for cost control and making efficient choices can be undermined
- Sub-market rents mean that the system has to be rationed
- … which makes matching what people want and what is available difficult
- … and mobility is hard to organise (and getting harder)
- You lose something valuable by exiting, so tenants can be captive to poor management
- Access through needs-based systems can feed stigma, and suspicions of queue-jumping and cheating
- So why not support people's access to decent housing through cash transfers or Housing Benefit, allowing them to buy or rent in a free market?

Reasons why should social housing (provision by non-profit landlords at sub-market rents) be an appropriate response for those in need?

- Paternalism: worries about how untied cash would be spent (leading to poor housing affecting individual in long-term, family, neighbours and neighbourhood)
- Worries about quality in private sector (legacy of "Rachmanism" still looms large for some)
- Worries about value for money if cash pushes up price for fixed supply
- Worries about geographical segregation if left to the market, leading to lack of mixed communities
- May want to balance advantages of others (eg. favourable tax treatment or access to inheritance) for equity reasons
- Worries about work incentives if support via means-tested benefits (esp. Housing Benefit in high cost areas)

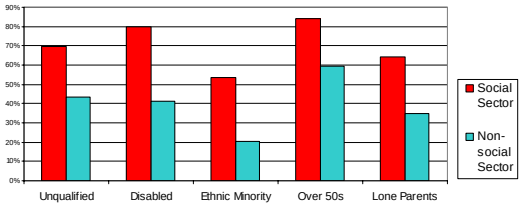
The last of these is perhaps the most important…

In high-cost areas, means-tested withdrawal of Housing Benefit can extend the "poverty trap" high up the earnings scale

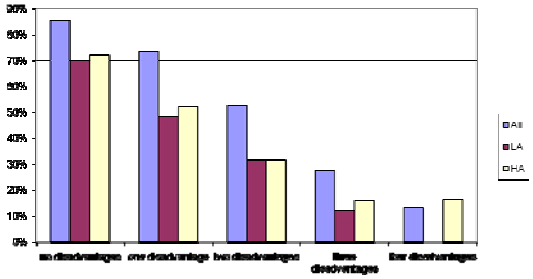


But worklessness is high in social housing, controlling for labour market disadvantage, despite the incentive from low rent

Worklessness by PSA group, Spring 2006



Employment rate by number of disadvantages



Source: Labour Force Survey, Spring 2006

What could we do? Policies to support work and social mobility

- We think of work and housing in separate boxes: if you go to a Job Centre you get a work solution, a housing office organises a housing solution, but problems may have same roots.
- In neighbourhood renewal, Jobcentre Plus and Local Skills Councils hard to engage, but potential big pay-off to DWP aims. Initiatives such as "Pathways to Work" have given very successful support for other groups.
- People have low understanding of getting HB in work or advantage of sub-market rents, and fear of benefit disruption. Case for less rapid HB adjustment and for work-related support after becoming a tenant. Prolonged periods in temporary accommodation paid via HB are very unhelpful for work agenda.
- Bridges to local employment: large amounts spent on estate residents, but not creating local jobs
- Crushingly low job-related mobility. Reflects emphasis on inflow (understandable given pressures). Ways of allowing more transfers for job-related reasons, including cross-border CBL pools?
- At radical end: in lower-demand areas, potential to get away from deep rationing eg through rents giving economic returns. Problems and solutions vary across country.

Conclusion

- The way we run subsidies for social housing and for social tenants doesn't just affect distribution, it also affects incentives for landlords and tenants to behave in particular ways
- Some of these are intended (eg to increase consumption of decent quality housing)
- But there are often unhelpful side-effects where systems are badly designed. Some of these create serious problems.
- But sub-market rents in social housing can help work incentives in high cost areas. But in the UK at the moment, it is hard to see those potential advantages being realised.

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