



Resolution Foundation

BRIEFING

Calculating a Living Wage for London and the rest of the UK

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Foreword

The Living Wage Foundation created the independent Living Wage Commission at the start of 2016 in order to oversee the rates of the voluntary Living Wage.

The Commission – made up of leaders from the private, public and voluntary sectors as well as academic experts – started its work by reviewing the different approaches that had hitherto been used to set the UK and London Living Wage rates. It recommended a number of changes to ensure an integrated approach to calculating the rates that properly reflects changes in the cost of living. The Living Wage rates announced last autumn for 2016/17 reflected these changes in methodology. It is the ongoing role of the Living Wage Commission to oversee the approach taken to rate setting, determine how to take account of policy shifts, and consider whether the appropriate data is being used.

This year there have been several important factors that have influenced the 2017/18 rises in the UK rate to £8.75 and the London rate to £10.20.

First, there is the wider inflation context. Inflation has been above the Bank of England's 2 per cent target for much of 2017. This is in no small part due to the fall in the value of the pound following the EU referendum. These faster price rises have fed through to the specific basket of goods and services used in the calculation of the Living Wage rates. The overall CPI rate was 2.7 per cent in April 2017 (the month on which the increase in Living Wage basket is based). But the cost of the goods and services that low-income households spend most on have typically risen faster than CPI, meaning that both the Living Wage rates are rising by more than the standard measure of inflation.

Second, there have been a number of important policy changes that need to be taken into account. Some of these changes offer more support to working individuals and families and therefore act as a downward pressure on the Living Wage rates (for instance, the increase in the personal tax allowance, reduction in social housing rents and additional childcare support). Other significant policy changes withdraw support from households and act as an upward pressure on the Living Wage rates (the continued freeze in working-age benefits, removal of the 'family element' of tax credits and the two-child limit on means-tested benefits). The impact of these policy changes varies greatly for different household types, depending on whether they have children (and their age). To a significant degree, however, the *net* impact of these different policy changes on the new Living Wage rates is relatively modest in that they tend to cancel each other out. It is also worth highlighting that there are some policy changes where the success of implementation remains particularly unclear – for instance, the increased free childcare support to 3 and 4 year-olds in England and Wales. The Commission will closely monitor implementation and uptake of this important policy.

Third, there is a specific and time-limited transition affecting the London rate. The 2016 review of the Living Wage rates concluded that the approach previously used in London resulted in too low a rate and proposed a new methodology to remedy this. As agreed by the Living Wage Commission, the implementation of this new approach is being phased in resulting in a temporary additional upward pressure on the London rate. This is the main reason the London rate is rising faster than the UK one in 2017/18.

There is currently significant uncertainty surrounding our future economic prospects. Despite record employment figures there are high levels of working poverty and real pay is falling. More than one in five employees get paid less than the real Living Wage. Against this challenging backdrop it is more important than ever that there is an independent and credible fair pay benchmark that is well understood by employers and workers and that informs our national discussion. It is the role of the Living Wage Commission to maintain this.

Gavin Kelly

Chair of the Living Wage Commission^[1]

[1] More detail on the Living Wage Commission, its work and the Commissioners is available at <https://www.livingwage.org.uk/living-wage-commission>

Introduction

This paper sets out the method for determining the independently-calculated Living Wage rates in London and the rest of the UK, and the respective rates that will apply from 6 November 2017. We detail the sources underpinning the calculations, based on the best available evidence about living standards and costs.

The calculation is built on a basket of goods and services that represents an acceptable standard of living, which is determined through research with members of the public. The hourly Living Wage rates are then calculated by taking a weighted average of the earnings required (accounting for tax and benefits) for a range of family types (with and without children) to meet that standard. These rates provide a benchmark for employers that voluntarily commit to go further than paying government-set minimum wages, ensuring their staff earn a wage that they can live on.

The first section of the report explains the basis of the ‘core basket’ of goods and services, including everyday items such as food and clothing, the cost of which varies relatively little across the country. The next section deals with costs that are more likely to vary between London and the rest of the UK, specifically housing, council tax, travel and childcare. Further detail relating to these assumptions and how they were initially reached is set out in the Resolution Foundation’s 2016 review of the Living Wage calculation for the Living Wage Commission, and in the Commission’s response.^[2] In this report, we set out where any of these assumptions or approaches may have changed as a result of changes in data, policy or significant shifts in consumption trends. Any such changes are formally agreed by the Commission as part of the annual rate-setting process.

The report then reflects on the process of transitioning from the previous methods to the one outlined here. As discussed in the above mentioned reports, the Living Wage Commission will play an ongoing role to ensure that this method uses the best available data sources and takes account of relevant policy changes.

The final section provides the Living Wage rates which apply in London and the rest of the UK from 6 November 2017. The Living Wage Foundation requires accredited Living Wage employers to implement the new rates as soon as possible and within six months of the annual announcement. We also set out detailed estimates of each living cost component for the different family types used in the calculation. The tax and benefit position of each family type is calculated using the Resolution Foundation micro-simulation model.

1. A core basket of goods and services

To provide a ‘basket’ of goods to underpin the Living Wage rates in both London (LLW) and the rest of the UK (UKLW), we use the Minimum Income Standard (MIS) research carried out by the Centre for Research in Social Policy (CRSP) at Loughborough University.^[3] A variety of household types are included in order to reflect the diversity of families across the UK (see Tables 1 and 2 for full details) with each basket varying by family type to reflect their specific requirements. Excluding those more variable goods and services discussed in Section 2, the same items are included in both the London and UK calculations.^[4] Because the prices of the items in the basket

[2] C D’Arcy and D Finch, *Making the Living Wage: The Resolution Foundation review of the Living Wage*, Resolution Foundation, July 2016; and Living Wage Commission, *Closing the Gap: A Living Wage that means families don’t go short*, September 2016

[3] The basket of goods and services for each family type and its costs can be found on www.minimumincome.org.uk with detailed baskets of goods and services available at www.jrf.org.uk/income-benefits/minimum-income-standards.

[4] As is discussed in the following section on housing costs, the sole exception we make to this is single people without children living in London. Because living alone in a studio or one-bedroom home is far less common in London, we apply a reduction based on the costs faced by people in shared accommodation, for example paying an appropriate share of heating bills. For further detail see K Hill, D Hirsch and M Padley, *Minimum budgets for single people sharing accommodation*, CRSP Working Paper 642, 2015

are drawn primarily from national chain stores, and research suggests that the prices of most of the contents of the core basket do not differ substantially across the UK, the cost of this section of the basket does not vary between the UKLW and LLW.^[5]

The rise in each of the components of the core Living Wage basket has been calculated using CPI this year. In previous years, the method utilised by the CRSP relied upon RPI. However, RPI has known faults and is no longer a recognised national statistic. The calculation this year uprates the cost of the core basket by CPI, matching the elements of the Living Wage basket as closely as possible to the available categories in CPI. While the overall CPI figure for the 12 months to April 2017 – the beginning of the financial year for which the rates are calculated – was 2.7 per cent, some components of the basket have risen more quickly than this and some more slowly.

2. Costs that vary more significantly across the UK

The following sections of this report outline those costs which vary more significantly between and within London and the rest of the UK, thereby requiring different data sources to be drawn upon rather than being included in the core basket.

2.1 Housing costs

To determine the type of accommodation required for different family types, we follow the findings of the MIS research. For the UKLW we use the following assumptions:

- » Singles and couples without children live in one-bedroom homes in the private rented sector (including studio accommodation for singles)
- » Households with one child live in a two-bedroom home in the social rented sector
- » Households with two, three or four children live in a three-bedroom home in the social rented sector

For the LLW, we broadly retain these assumptions. However, for singles without children, and in order to reflect the high cost and availability of one-bedroom flats in London, some are assumed to share. We use a weighted average based on analysis of the 2011 census which found that 54 per cent of singles live in shared accommodation.^[6]

The housing costs associated with each type of accommodation are drawn from a variety of sources, using the latest available data. Average social sector rents are taken from the 2017 UK Housing Review, using the London estimate and an average for the UK excluding London for 2016-17. We then uprate those rent levels in line with current policy which is to decrease social sector rents by 1 per cent in 2017-18. An average for only three-bedroom properties is no longer provided so we produce an estimate taking the differential when last available (in 2014).

For the private rented sector, consistent UK-wide data is not available. For the UKLW, we take the best available data from each nation and produce a weighted average. The data used for England are published by the Valuation Office Agency.^[7] For Scotland, the data are published by the Scottish Government.^[8] For Wales, the data are published by StatsWales.^[9] For Northern Ireland, the data

[5] For further discussion of London costs and living standards research see M Padley et al, *A Minimum Income Standard for London*, Loughborough University/Trust For London, May 2015

[6] K Hill, D Hirsch and M Padley, *Minimum budgets for single people sharing accommodation*, CRSP Working Paper 642, 2015

[7] Valuation Office Agency, *Private Rental Market Summary Statistics – April 2016 to March 2017*, July 2017

[8] Scottish Government, *Private Sector Rent Statistics, Scotland, 2010 to 2016*, November 2016

[9] StatsWales, *Private sector rents by local authority, 1 January to 31 December 2016, 2017*

are published by the Analytical Services Unit of the Department for Social Development.^[10] For the LLW, the London data published by the Valuation Office Agency is used. In both the UKLW and LLW, the rents taken are at the lower quartile in the private rented sector.

The sample taken by the Valuation Office Agency statistics can mean that year-to-year fluctuations occur in the detailed breakdown of rents reported – especially in London. We therefore take a three-year rolling average of rents for both London and the rest of the UK. Doing so minimises annual volatility but also means that it takes longer for the most recent trends to become apparent. Tables 1 and 2 show how these costs vary by room size for the UKLW and LLW.

2.2 Council tax

Different family types are assumed to pay different rates of council tax, based on the number of children they have and how this is likely to affect their housing needs. A weighted average of the total council tax bill for a Band D property in each billing authority is used as a baseline, calculated from published UK^[11], Scottish^[12] and Welsh^[13] government statistics on Band D rates. This is then adjusted to the relevant band for each family type.

For the rest of the UK, the bands denoted in MIS research are applied (a couple without children, in Band B, pays seven-ninths of the Band D rate while families with children, in Band C, pay eight-ninths). For London, the same assumptions apply except that families with more than one child are assumed to live in a Band D property. Single adult reductions of 25 per cent are applied to all single person households in the UKLW calculation and to those treated as living alone in the LLW calculation (46 per cent of singles).

2.3 Travel costs

The travel cost assumptions for the UKLW are drawn from MIS research. In London, a weighted average is used across Inner and Outer London families. In Outer London, the cost of a monthly zone 4-6 travelcard is included and for those in Inner London, a monthly zone 1-3 travelcard.^[14] For families with children aged 11 plus, two journeys a day for five days a week (to get to and from school) are budgeted for, taking account of the cost of and savings provided by a Zip Card – a card entitling under 18s to discounted travel. The values for these figures at the time of calculation are included in Table 2.

2.4 Childcare costs

Given we assume all adults in the calculation work full-time – 37.5 hours per week in line with the UK average – all families with children aged 11 and under are assumed to use full-time childcare (42.5 hours per week). This is calculated for 47 weeks of the year, taking account of hours provided through the free early years education offers, school and the school holidays. Full-time nursery care is assumed for pre-school aged children all-year round, after-school clubs for children of primary school age during term-time and childminder provision during school holidays.

[10] Department for Social Development, *Northern Ireland Housing Statistics 2015-16*, November 2016. Because the data for Northern Ireland supplies only a median figure and for a more limited range of accommodation we make adjustments to these, based on the relationship between different sized properties e.g. ratio of the cost of a studio to a one bedroom flat and the median and lower quartile.

[11] DCLG, *Council Tax levels set by local authorities in England 2017 to 2018*, March 2017

[12] Scottish Government, *Council Tax by Band 2017-18*, May 2017

[13] StatsWales, *Average band D council tax, by billing authority*, March 2017

[14] Transport for London, *Adult rate prices: All Tube, DLR, London Overground and TfL Rail services and National Rail services in Z1-9*, 2017

Costs are calculated using the most recent data collated by the Family and Childcare Trust.^[15] For the UKLW, a weighted average for the regions/nations of the UK excluding London is calculated, weighted by the number of children. For the LLW, we use an adjusted average taking account of the differential between London and the rest of the UK, based on 2016 data.^[16]

This year's calculation assumes that the government's policy of providing an additional 15 hours of free childcare (bringing the total to 30 free hours) for working parents of 3 and 4 year-olds in England and Wales is in place.^[17] However, the data available on the implementation of this commitment is limited. As such, it is unclear how far demand for provision will be met, or what the effect of the policy will be on childcare prices. In our discussions on this topic, the Living Wage Commissioners stressed that this lack of data was unsatisfactory and they would be willing to review the application of this policy in the calculation should new data become available.

3. Tax and benefit system

The taxes paid and benefits received by each family type are calculated using the Resolution Foundation micro-simulation model. We assume that each family type claims every benefit to which they are entitled. We include policy changes applying to the 2017-18 financial year including the increase in the personal tax allowance to £11,500; the continued freeze in working-age benefit rates; the removal of the 'family element' for families in which their first child was born after March 2017; and the limiting of support for families with at least two children who have additional children after March 2017.

Though Universal Credit is in place in some parts of the country, the great majority of families – particularly those who are in work and have children – have not switched over to the new system. Given this limited coverage to date, the Living Wage Commissioners opted to only use the tax credit system within this year's calculation. The situation will be reassessed before next year's calculation to decide whether a meaningful share of the relevant population has moved onto Universal Credit.

4. Implementing the new methodology

Last year marked a shift from the previous methodologies used for the UKLW and LLW to a new aligned process. Moving from one formula-based approach to another inevitably requires a transitional period during which the new method beds in. As such, the Living Wage Commission's guidance upon the completion of the review and agreement on a new methodology was that there should be a time-limited phase-in period for the new method for the London rate.^[18] This year is the second step in this phase-in, with the 'reference rate' provided in Table 2 and the 'applied rate' given in Section 5 below.

5. Living Wage rates for 2017-18

The rate for the UKLW for 2017-18 is £8.75.

The rate for the LLW for 2017-18 is £10.20.

[15] C Harding, B Wheaton & A Butler, *Childcare Survey 2017*, Family and Childcare Trust, March 2017

[16] For the LLW, we remove the highest outlier estimates that upwardly skew the resulting London average.

[17] As well as only applying to families with children within this age bracket, the policy was introduced from September 2017. As such, the reduced spending by families on childcare will only apply for the portion of the year for which it has been in place and only takes effect in England and Wales.

[18] Living Wage Commission, [Closing the Gap: A Living Wage that means families don't go short](#), September 2016

Tables 1 and 2 provide a detailed breakdown of each of the components of the calculation addressed above.

6. Conclusion

This report has set out the method through which the Living Wage rates in London and the rest of the UK are calculated. This aligned approach ensures that both the UKLW and LLW will be driven by the latest research into changes in the cost of living and that they reflect what is needed to meet a decent standard of living for a variety of family types in the UK today.

Table 1: Breakdown of UK Living Wage (excluding London) calculation

£ per week

Family type	"Core" basket			Living costs (£ per week)		Childcare	Travel	Total	Hourly wage requirement	Weights
	Core basket	Rent	Council tax	Council tax	Travel					
Single	159.73	88.72	17.61	17.61	29.76	-	295.81	9.15	32.5%	
Couple	261.14	96.57	23.47	23.47	59.51	-	440.69	6.15	33.8%	
Single parent with one child (age 3-4)	231.71	79.55	20.12	20.12	55.95	100.73	488.05	12.65	1.1%	
Single parent with one child (age 5-11)	252.63	79.55	20.12	20.12	56.50	65.52	474.32	13.70	3.8%	
Single parent with two children (age under 3 & 3-4)	269.00	87.31	20.12	20.12	58.67	268.90	704.00	16.20	0.2%	
Single parent with two children (age 3-4 & 5-11)	296.47	87.31	20.12	20.12	59.81	166.25	629.96	15.50	0.6%	
Single parent with two children (age 5-11 & 12-16)	343.02	87.31	20.12	20.12	69.68	65.52	585.64	18.10	1.7%	
Single parent with three children (age 3-4 & 5-11 & 12-16)	387.75	87.31	20.12	20.12	71.85	166.25	733.28	19.10	1.1%	
Couple parent with one child (age 3-4)	293.79	79.55	26.83	26.83	74.18	100.73	575.07	7.50	3.9%	
Couple parent with one child (age 5-11)	314.75	79.55	26.83	26.83	74.80	65.52	561.44	8.05	6.8%	
Couple parent with two children (age under 3 & 3-4)	330.68	87.31	26.83	26.83	76.79	268.90	790.51	9.50	1.6%	
Couple parent with two children (age 3-4 & 5-11)	358.17	87.31	26.83	26.83	78.01	166.25	716.57	8.90	2.6%	
Couple parent with two children (age 5-11 & 12-16)	404.72	87.31	26.83	26.83	87.97	65.52	672.36	10.05	6.2%	
Couple parent with three children (age under 3, 3-4 & 5-11)	412.73	87.31	26.83	26.83	80.73	334.42	942.01	13.70	0.5%	
Couple parent with three children (age 3-4 & 5-11 & 12-16)	465.78	87.31	26.83	26.83	91.13	166.25	837.30	11.55	0.9%	
Couple parent with three children (age 5-11, 5-11 & 12-16)	513.69	87.31	26.83	26.83	100.87	65.52	794.21	12.15	1.5%	
Couple parent with four children (age under 3, 3-4, 5-11 & 12-16)	504.38	87.31	26.83	26.83	94.13	348.13	1,060.78	15.90	1.0%	
Weighted hourly wage equivalent								8.75		

Source: Resolution Foundation analysis using the RF microsimulation model, ONS, Annual Population Survey December 2014-16 and other sources detailed in the main body of this report.

Notes: Calculations assume that the current (2017-18 financial year) tax and benefit system is in place with all families entitled to the tax credit system. Weights use a three-year average of the population of families using the Annual Population Survey 2014-2016 where at least one adult is aged between 16 and 64.

Table 2: Breakdown of London Living Wage calculation

Family type	Living costs (£ per week)				Hourly wage	Weights
	"Core" basket	Rent	Council tax	Travel		
Single	149.38	141.80	9.67	26.96	10.40	43.1%
Couple	261.14	228.00	20.14	53.91	8.55	24.6%
Single parent with one child (age 3-4)	228.20	119.04	17.26	26.96	11.55	1.0%
Single parent with one child (age 5-11)	250.60	119.04	17.26	26.96	124.08	4.0%
Single parent with two children (age under 3 & 3-4)	264.10	133.36	19.42	26.96	73.49	0.3%
Single parent with two children (age 3-4 & 5-11)	292.98	133.36	19.42	26.96	334.39	0.7%
Single parent with two children (age 5-11 & 12-16)	340.50	133.36	19.42	32.84	197.56	2.0%
Single parent with three children (age 3-4 & 5-11 & 12-16)	382.64	133.36	19.42	32.84	197.56	1.6%
Couple parent with one child (age 3-4)	289.58	119.04	23.01	53.91	124.08	3.9%
Couple parent with one child (age 5-11)	312.08	119.04	23.01	53.91	73.49	8.55
Couple parent with two children (age under 3 & 3-4)	324.97	133.36	25.89	53.91	334.39	1.7%
Couple parent with two children (age 3-4 & 5-11)	353.95	133.36	25.89	53.91	197.56	2.5%
Couple parent with two children (age 5-11 & 12-16)	401.58	133.36	25.89	59.80	73.49	4.8%
Couple parent with three children (age under 3, 3-4 & 5-11)	407.12	133.36	25.89	53.91	407.88	0.5%
Couple parent with three children (age 3-4 & 5-11 & 12-16)	461.12	133.36	25.89	59.80	197.56	1.0%
Couple parent with three children (age 5-11, 5-11 & 12-16)	510.00	133.36	25.89	65.69	73.49	1.6%
Couple parent with four children (age under 3, 3-4, 5-11 & 12-16)	498.32	133.36	25.89	59.80	407.88	1.3%
Weighted hourly wage equivalent					10.45	

Source: Resolution Foundation analysis using the RF microsimulation model, ONS, Annual Population Survey December 2014-16, October 2016 and other sources detailed in the main body of this report.

Notes: Calculations assume that the current (2017-18 financial year) tax and benefit system is in place with all families entitled to the tax credit system. Weights use a three-year average of the population of families in London using the Annual Population Survey 2014-2016 where at least one adult is aged between 16 and 64. The living costs of a single shown are weighted averages accounting for individuals living in shared accommodation.

Resolution Foundation

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- » *developing practical and effective policy proposals; and*
- » *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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