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BRIEFING PAPER

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Rent setting: social housing (England)

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Summary

In 2002 the Labour Government introduced a rent convergence policy under which, over a ten year period, rents in social housing (local authority and housing association owned stock) were to be brought into alignment.

A rent formula was established with actual rents moving towards a national formula rent which took account of values of properties and local earnings relative to national earnings. A 'bedroom weighting' factor was also applied to try and ensure the resulting rents better reflected the perceived value of the properties being occupied. These formula rents were increased each year by the Retail Prices Index (RPI) + 0.5%.

The Coalition Government continued this rent setting process with (initially) a revised target convergence date for local authorities of 2015-16, subject to a maximum annual rent rise for an individual tenant of RPI + 0.5% + £2 per week.

As part of the 2013 Spending Round the Coalition Government announced that "from 2015-16 social rents will rise by CPI plus 1 per cent each year for 10 years." Following this announcement, DCLG sent a letter to housing bodies on 2 July 2013 in which plans to cut short the policy of converging council and housing association rents were revealed. Social landlords whose average rents had not yet reached target levels were concerned about the implications on their ability to repay debt and invest in new and existing social housing stock, but the certainty delivered by a 10 year rent settlement was welcomed.

The Rents for social housing from 2015 to 2016: consultation was published in October 2013 with a summary of responses published in May 2014. At the same time, the Government published its policy on rents for local authority owned social housing from April 2015 onwards - Guidance on rents for social housing. The guidance confirmed the intention to proceed with its policy of ending rent convergence in April 2015, and that CPI plus 1 per cent would form the basis of rent increases for the next ten years.

The certainty of the 10 year settlement was short-lived as on 8 July 2015 (Summer Budget 2015) the Chancellor announced that rents in social housing would be reduced by 1% a year for four years resulting in a 12% reduction in average rents by 2020-21. The measure is forecast to save £1.4bn by 2020-21, primarily in reduced Housing Benefit expenditure. Around 1.2m tenants not in receipt of Housing Benefit in the social rented sector are expected to benefit by £700 per year (current prices).

This policy change was unexpected and has been greeted with some dismay by social landlords who are now modelling the impact on their business plans. The Office for Budget Responsibility (OBR) is predicting a reduction in housing investment as a result of the policy which will be implemented by measures contained in the *Welfare Reform and Work Bill* (currently progressing through Parliament).

1. Rent restructuring and convergence under Labour

1.1 Background and rationale

The different rent levels charged by councils and private registered providers of social housing[1] has, historically, reflected when and where the housing had been built over many decades; changes in the capital and revenue subsidies given to social landlords; and the different rent policies pursued. The Labour Governments of 1997-2010 wanted to see an end to 'arbitrary' differences between the rents of similar properties in a locality and between similar properties in neighbouring areas:

> For example, in a report published in 2000, the Chartered Institute of Housing cited two adjoining London boroughs where one charged £15 more each week than its neighbouring borough for properties of a very similar standard. And in a large southern city there was a £24 gap in the rent charged each week by the local authority and a local registered social landlord for otherwise similar three bedroom homes. Tenants see that it is unfair when there is no apparent explanation for the pattern of rents in a locality, whether in terms of relative property quality, relative attractiveness of location or relative running costs.[2]

The then Minister for Housing, Sally Keeble, outlined the rationale behind rent restructuring in an adjournment debate in December 2001:

> Our policy on rent restructuring is part of the Government's wider housing agenda. The aim is to close the gap between rents in different sorts of social housing and, as my hon. Friend said, to pave the way for greater choice for social housing tenants. That applies not just to different council properties in the same area but to different sorts of social housing tenure, because at present the perception that housing association rents are high can be a bar to people who might consider applying for that sort of housing. We want a sensible structure of rents so that tenants can choose whether to pay more for a better property or to save money by choosing a less popular property. To achieve that, we are establishing a common basis for social rents throughout England by linking rents to both the value and size of the property and to manual earnings in the area. The new rents must be affordable and we are linking them to local earnings to ensure that. They will not be market rents. Rents in the social sector throughout most of the country will generally remain well below what a tenant would pay for the property from a private landlord. I said that that will apply throughout most of the country, because some areas have very low demand and different trends in property prices.[3]

The Labour Government's policy was that all social landlords (local authorities and housing associations) should offer similar rents for similar properties, whilst maintaining substantial discounts to market rents.

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1 Also referred to as housing associations and registered social landlords (RSLs).
2 Housing Green Paper, *Quality and Choice: A decent home for all*, April 2000, para 10.13
3 HC Deb 5 December 2001 c135WH

Preparing for restructuring involved calculating the 'formula rent' which was the target rent figure for each individual council and housing association home for ten years' time (i.e. by 2011/12 initially). The formula rent was based on a combination of individual property values and average earnings in each area.[4] Each year the Department (now Communities and Local Government, DCLG) suggested a "guideline" rent level to which councils should move their rents in order to help them eventually reach their formula rents at the end of the ten year period in 2011/12.[5]

DCLG included information for local authorities on proposed national guideline rents in the draft Housing Revenue Account determination which was issued at the end of each calendar year (prior to the implementation of self-financing in April 2012). The formula for calculating guideline rents was not contained in legislation - for local authorities the formula was RPI + 0.5% plus £2 per week. The reference point for RPI was the September in the year preceding the start of the financial year to 31 March.

The consultation paper, [The Reform of Council Housing Finance], published in July 2009, contained the following summary of the Government's rent setting policy:

> 2.23 The rent formula was established by Government to gradually bring about this policy, with actual rents moving towards a national formula rent that took account of values of properties and local earnings relative to national earnings. A 'bedroom weighting' factor was also applied to try and ensure the resulting rents better reflected the perceived value of the properties being occupied. These formula rents have been increased each year since 2002 at RPI +0.5%.
>
> 2.24 The original objective was that actual rents would converge to within 5 per cent of formula rents by 2012, by applying annual increases above or below the increase in formula rents, but subject to a maximum annual increase in actual rent of RPI+0.5%+£2 per week. (The £2 is therefore the maximum annual 'catch-up' for rents which are below formula.)
>
> 2.25 The HRA subsidy system requires Government to make assumptions each year about the rental income of every council landlord and to take a view about progress towards restructuring for each council. This has led to complex calculations within the subsidy system, using trajectories for each council based on their actual rents at the start of the restructuring process.
>
> 2.26 In addition, mechanisms have been introduced to compensate landlords for charging rents below the guideline rent, if moving to the guideline rent would breach aspects of the overarching rent policy. These have included a cap on actual rent rises of RPI+1/2%+£2, and a ceiling on individual rent rises which have, from time to time, been included in the annual subsidy determination itself.

The rent influencing regime for housing associations is governed by the Regulation Committee within the Homes and Communities Agency

4 Property values are weighted by 30% in this calculation with a 70% weighting on local earnings.

5 This completion date was later put back to 2015/16.

(HCA). In October 2001 the then regulatory body, the Housing Corporation, published guidance for associations, *Rent influencing Regime: Implementing the Rent Restructuring Framework,* which stated:

> The Corporation expects each association to have an initial plan ready by April 2002. We will not call in plans from those who expect to achieve target rents by 2012; but we shall monitor progress through regular returns and the lead regulation process. Any association which is experiencing difficulty in establishing such a plan should speak to its lead regulator. The guidance recognises that there are potentially over-riding concerns, and plans will need to reflect them. Smaller associations should also plan to achieve target rents to the same timescale. But the scale and nature of any planning should be commensurate with the scale and nature of the association.

The regulatory body issues annual guidance for associations on the implementation of the rent influencing regime. The Guideline rent limit for private registered providers 2015 to 2016 was published in December 2014.

The Rent Standard Guidance published in March 2012 by the HCA consolidated all of the previous guidance issued by the Housing Corporation and adopted by its successor body the Tenant Services Authority (TSA).

1.2 Further developments (2007 onwards)

Rent setting 2008-09 and 2009-10

In August 2007 DCLG issued a consultation paper, Mechanism for setting Guideline Rents in Housing Revenue Account subsidy 2008-09 and 2009-10, which included options on setting guideline rents predicated on a rent convergence date of 2011-12 or an extended date of 2016-17:

> **Andrew Stunell:** To ask the Secretary of State for Communities and Local Government when she expects to announce her decision whether to return to the basic rent restructuring formula with caps and limits or extend rent restructuring to reduce the steepness in the trajectory guideline and actual rent rises.
>
> **Caroline Flint:** Communities and Local Government consulted on the mechanism for the setting of guideline rents in the Housing Revenue Account (HRA) subsidy regime in August. The options consulted on were guideline rents predicated on a rent convergence date of 2011-12, or extending the convergence date to lower annual guideline rent increases. A decision on the preferred option (extending the convergence date to 2016-17, solely for the purpose of calculating guideline rents in the HRA subsidy system for 2008-09) was included in the HRA subsidy determination for 2008-09 which was issued in draft for consultation on 23 November 2007 and in final form on 15 January 2008.[6]

The proposal to extend the convergence date was welcomed by tenants' groups. Sam Lister, policy officer at the Chartered Institute of

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[6] HC Deb 22 February 2008 cc1047-8

Housing (CIH), said that the proposals "were a sign that rent restructuring had slipped down the list of government priorities."[7]

In August 2008 the Department consulted on how the Housing Revenue Account (HRA) subsidy determination would be handled in 2009-10 and 2010-11. A key element of this consultation concerned guideline rents. As noted previously, DCLG included information for local authorities on proposed national guideline rents in the draft HRA determination which was usually issued at the end of each calendar year. The reference point for RPI in the formula for setting guideline rents was the September in the year preceding the start of the financial year to 31 March.

In *Handling of the Housing Revenue Account Subsidy Determination 2009–10 and 2010–11*[8] DCLG asked authorities for views on how inflation rates should be assessed for the purposes of setting guideline rents:

> There are two practical options for the immediate future of rent policy over the next two financial years.
>
> Comments from stakeholders are welcome particularly on the following possibilities which have been discussed in detail above:
>
> Fixing and pre-setting guideline rent increases with reference to assumed inflation rates for 2009-10 and 2010-11 respectively; or
>
> Allowing guideline rent increases to follow their course to convergence in 2011-12 in line with the rent restructuring formula, using the forecasts of inflation in September 2008 and September 2009 for the respective financial year.
>
> Comments from stakeholders are also welcome on a possible option for limiting higher end actual rent increases.

Following this consultation process, DCLG issued a letter to all local authorities on18 December 2008 in which it advised that a majority of authorities had preferred the first option in relation to inflation and setting guideline rents:

> Two options were presented for setting guideline rents; a majority of the representations received favoured the Department's preferred option of a fixed 6.1% increase in guideline rents, based upon the September RPI and creating a consequent delay in the convergence date. Ministers have now considered the comments and representations received and, subject to taking account of later information where necessary, they have decided to confirm the proposals in the consultation and to confirm that the Determination is calculated using the Department's preferred option for rent increases as noted here.[9]

It was therefore proposed that the September 2008 RPI figure of 5% would be applied to council tenants' guideline rent increases in

7 "Plans to align social rents by 2012 set for scrapheap", *Inside Housing,* 7 September 2007

8 Link no longer operational: http://www.communities.gov.uk/documents/housing/doc/handlinghrasubsidy.doc

9 Link no longer operational: http://www.communities.gov.uk/documents/housing/pdf/hradeterminationsletter200910 (no longer operational)

2009-10, this was not without controversy. Councils faced a backlash from tenants facing average rent increases of 6.2% at a time of falling inflation.[10]

The then Government, when questioned on this issue, initially emphasised that it was up to local authorities to set their own rent levels and that the rent restructuring process contained provisions to protect individual tenants from excessive rent rises.[11] A spokesperson from DCLG reportedly said that local authority rent increases should amount to no more than an estimated average of £3.95 per week and for over 60% of tenants these increases would be covered by Housing Benefit.[12]

Local authorities argued that if they set rent levels below the guideline rent this would only put off rent increases to a later date as the requirement for convergence with RSL rent levels by 2023 (a date which was likely to be brought forward if inflation continued to fall) would still stand. The second factor that militated against setting rents below the guideline was the fact that HRA subsidy assumed that authorities had increased rents by the guideline amount. Thus a lower rent rise did not increase the amount of subsidy an authority would receive, resulting, for those authorities in receipt of subsidy, in a budget shortfall. Negative subsidy authorities, i.e. those that paid surpluses on their HRAs to the Government for redistribution to authorities with deficits on their HRAs, argued that because their HRAs were in surplus they should not have to put up tenants' rent levels by any more than they needed to.[13] Additional information on the HRA subsidy system can be found in Library briefing paper 04341.

DCLG issued a Written Statement on 6 March 2009 announcing that authorities would be allowed to bid for additional HRA subsidy if they were prepared to revisit their rent increases and reduce them. The national average guideline rent increase for 2009-10 was reduced from 6.2% to 3.1%.[14] The reduction in the guideline rent increase was expected to produce average rent increases for council tenants of £2 per week instead of £4 per week.[15]

For housing associations, the Tenant Services Authority (TSA, then the regulatory body of housing associations) advised that they were not obliged to apply the full 5.5% guideline limit for rent increases in 2009-10:

> The all items RPI for September 2008 was 5% and therefore the guideline limit for rent increases in 2009-10 is 5.5%. This was published in Housing Corporation Circular 04/08 Rents, Rent Differentials and Service Charges for Housing Associations.
>
> Registered providers are reminded that there is no requirement on them to apply the full guideline limit to rent increases if they can

10 "This is a ludicrous situation", *Inside Housing,* 23 January 2009
11 HC Deb 20 January 2009 cc616-7
12 "Rebellion brews over proposed rent hikes", *Inside Housing,* 16 January 2009
13 "This is a ludicrous situation", *Inside Housing,* 23 January 2009
14 HC Deb 6 March 2009 c71WS
15 DCLG Press Release, "Beckett cuts planned council rent increases in half", 6 March 2009

> remain viable based on lower rent increases. Some registered providers will opt to increase rents by less than the guideline limit in 2009-10. However, for others this will not be a viable option having already suffered the higher inflationary levels through the impact on their cost bases.
>
> The TSA is discussing with Communities and Local Government (DCLG) the approach to future rent restructuring and in particular the implications for the guideline limit in 2010-11.[16]

Rent setting 2010-11

The Labour Government made a commitment to look again at the 2010-11 national guideline rent increase for local authorities in light of circumstances closer to the start of that financial year.[17] On 9 December 2009 DCLG issued for consultation the draft HRA subsidy determination for 2010-11. The accompanying letter to all local authorities contained the following information on guideline rent increases:

> In February this year we promised to review the previously established average guideline rent increase for 2010-11 of 6.1%. As a result of that review we have decided to consult on an average guideline rent increase of 3.1%.
>
> Rents and rent restructuring
>
> Fixing the reduced guideline rent increase at 3.1% has been achieved by changing the convergence date. To achieve a specific guideline rent increase of 3.1% it has been necessary to use a convergence date (n) of 3 years.
>
> The key issue in this consultation concerns the average guideline rent increase for 2010-11. As you will be aware, the average guideline rent increase for 2010-11 established in December 2008 was 6.1%. After taking into account the continuing economic conditions, the September 2009 RPI -1.4%, and current rent re-structuring policy, the average guideline increase has been reduced to 3.1%.[18]

The consultation period ended on 25 January 2010 and the final HRA subsidy determination was issued on 3 February 2010.[19] The decision to aim for convergence by 2012-13 meant that target rents might have to increase more steeply than had been expected.[20]

Considerable concern was expressed by associations in response to the forecast for negative inflation in September 2009. Translating negative inflation into the formula of RPI + 0.5% meant associations having to reduce their rents in 2010-11. Associations argued that this would impact on their ability to service loans and raise finance for new development. In fact in 2007 the representative body of housing associations, the National Housing Federation (NHF), called on the Government to give associations greater scope to increase tenants' rents. In a letter to the then Minister for Housing, Yvette Cooper, the

[16] Link to statement is no longer operational [http://www.tenantservicesauthority.org/server/show/ConWebDoc.16647/changeNav/13640]
[17] HC Deb 9 March 2009 c29W
[18] DCLG, *Draft HRA Subsidy Determination 2010-11*, 9 December 2009
[19] DCLG, *Final HRA Subsidy Determination*, February 2010
[20] *Inside Housing*, "Councils face new year rent headache", 8 January 2010

NHF argued for a move to rent setting based on RPI + 1% instead of RPI + 0.5%. The basis of this claim was the need to boost the borrowing power of housing associations.[21]

An article in *Inside Housing* Magazine of 20 February 2009 expressed concern about the impact of negative inflation on housing associations:

> The rent formula is also causing concern among housing associations, who have warned that the possibility of negative inflation this autumn could force them to lower rents, dragging down their income levels.
>
> Gavin Smart, assistant director at the National Housing Federation, said it was in discussions with the Tenant Services Authority and the government to press for a 'rent floor', which would allow associations not to reduce rents if inflation fell below zero.
>
> The NHF was disappointed with the stance the TSA had taken on the issue, Mr Smart said. 'It is likely that members might have to cut back on tenant and neighbourhood services and investment and improvement of their existing homes in order to make ends meet.'
>
> A TSA spokesperson said: 'The TSA recognises the potential risk of deflation and is working very closely with the DCLG in thinking through what it might mean for the sector.[22]

The TSA issued a further notice in March 2009 in which it recognised that inflation in September 2009 might be much lower and that there was a need to ensure the financial viability of associations:

> We would remind Housing Association landlords of the guidance we issued last month stating that the rent formula permits a maximum rate of increase. It is for landlords to set their rents within this maximum taking account of the impact on tenants and future tenants and landlords' financial commitments, which include their commitments to invest and raise service delivery for the homes they currently own and their commitments to build much needed new homes.
>
> We are keen to ensure broadly consistent outcomes over time for social tenants regardless of who their provider happens to be. In this light, we note that the inflation escalator used in the rent formula for next year could be much lower than this year if current inflation trends persist. We welcome the Government's commitment to work with us in monitoring the potential impact of these developments on the guidance for rent levels that should apply in 2010/11 - both in terms of its potential impact on tenants' bills and the viability of Housing Association's business plans.[23]

In July 2009 DCLG published a consultation paper on the draft directions which would apply to the TSA. This consultation related to the regulatory standards that the TSA would operate in relation to rents, standards of accommodation and tenant involvement. On rents, the draft direction provided:

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21 *Inside Housing,* "Federation urges Cooper to allow bigger rent hikes", 20 April 2007
22 *Inside Housing*, "Councils plead for U-turn on rent increases", 20 February 2009
23 Link no longer operational

34. Most commentators expect the level of inflation (RPI) for September 2009 to be negative, and as a result rent rises in 2010-11 based on that figure are likely to be much lower than in 2009-10. This creates potential problems for landlords. RSL business models and financial arrangements are not the same as those of local authorities, although both types of body are not for profit organisations. RSLs depend on rental income to provide funding for management services, carry out promised improvement programmes and raise private finance to build new social homes. If the formula were applied in the usual way where inflation was strongly negative, there would be a sharp drop in rental income for a significant number of RSLs, with implications for services to tenants and the new development of social housing.

35. For this reason, the Secretary of State has decided to consult on a change to the formula to permit a floor of minus 2 per cent on increases to rent levels in 2010-11. This means that where the application of the RPI + 0.5 per cent formula would normally lead to a fall in rent levels of more than 2 per cent, registered providers would not be obliged to reduce the rent by more than 2 per cent.

36. The rationale for the proposed floor of minus 2 per cent is to protect registered providers from a particularly sharp drop in rental income, and also to give them certainty about the minimum amount of rental income they can expect next year.

37. We recognise that some housing associations are concerned about the prospect of any nominal-terms reduction in rental income next year. Indeed, we considered the case for a floor of 0 per cent that would have allowed registered providers to freeze their rents in the event of deflation in September 2009. However, we had to balance these concerns with the interests of rent payers and the potential impact on the public finances of higher rent increases than would have arisen from the application of the normal formula. We also had to take account of the fact that housing associations were able to set relatively high rent increases for 2009-10 due to the level of RPI inflation in September 2008.

38. Alongside the proposed rent floor, TSA will continue to work with any individual registered providers who are in financial difficulty. Where the application of the rents standard would cause a provider to be unable to meet other standards, particularly in relation to financial viability, TSA can – where necessary – give the provider an extension to the period over which the requirements of the standard need to be met.

39. We have considered the likely costs of the proposed minus 2 per cent rent floor, compared to a scenario in which there was no floor. It is important to note that the floor would have no effect if RPI inflation in September 2009 was minus 2.5 per cent or higher. For example, if RPI inflation in September was minus 2 per cent, the floor would not have any effect. However if, as was forecast in Budget 2009, RPI inflation was minus 3 per cent, the floor would come into effect. In that scenario, we estimate that the cost to those paying rents would be around £391m more over ten years (NPV) than if there was no rent floor. Approximately two thirds of this total would be met by housing benefit.

40. The proposed direction imposes a rent floor for one year only, but the Government does not rule out proposing a floor for future

> years should it be necessary – this would be achieved through another direction.[24]

The consultation period closed on 9 October 2009 and the final directions were issued by DCLG in November 2009 under section 197 of the *2008 Housing and Regeneration Act*.[25] The TSA published its guidance for associations later in November 2009:

> The proposed TSA standard on rents is planned to come into effect from 1 April 2010. That proposed standard, set out as a result of a DCLG direction, continues the principles of rent restructuring previously published and it is therefore a regulatory requirement that housing associations should keep their annual rent changes to no more than the set guideline limit specified by the TSA. This is subject to the requirement that an individual rent does not change by more than £2 a week, in addition to the guideline limit — ie RPI+0.5% plus £2 per week, in any one year. **DCLG has made it clear in its direction that it expects guideline rents limits to track RPI whether that be upwards or downwards.**[26]

The guidance set out the circumstances in which the TSA might grant an association an extension to compliance:

> The TSA board has agreed that we will take into account the following when considering the case for extensions where complying in full with the restructuring formula would cause:
>
> - a breach of covenant or other loan default before March 2013, or
> - existing loan facilities to be exceeded by March 2013, or
> - significant tenant promises to be broken where these were part of a stock transfer deal
>
> Providing that all reasonable mitigating actions will be taken, including (but not exhaustively):
>
> - making full use of restructuring flexibility, including the 105% tolerance
> - cancelling or postponing uncommitted development projects
> - re-profiling major repairs programmes where possible
>
> Associations will be expected to submit a business case to the TSA for approval. This should be a base-case plan and must include scenarios demonstrating compliance with the criteria above, plus relevant highlights from covenants and rent plans. The association should focus on a short-term timescale and demonstrate that it has taken full account of any possible efficiencies and adjustments to their cost base.[27]

The National Housing Federation reacted angrily to the draft direction on rents claiming that cutting rents by up to 2% in 2010-11 would cost

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24 DCLG, *Directions to the Tenant Services Authority*, July 2009
25 DCLG, *The Directions on Regulatory Standards*, 10 November 2009
26 TSA, *Rents, rent differentials and service charges 2010-11*, November 2009
27 Ibid.

the sector £260m a year. It argued that this could reduce affordable housing development by 4,000 homes a year from 2010:

> Federation chief executive David Orr said: "We know that public spending is tight and you get a sense that in order to fund Building Britain's Future the Government shook every sofa in Whitehall to see what fell out. But then, having accumulated enough to make an impact, they undermine the capacity of the people they need to deliver it.
>
> "Reducing rents by 2% next year won't just leave a hole in capacity for one year, but for ever. Not everyone will pull back from building – they will find the cuts from elsewhere – but that hole in capacity translated into homes is 40,000 in a decade. That's 40,000 safe secure places for 40,000 families to thrive."
>
> The rent increases that housing associations can levy on their tenants are limited by a formula of September's Retail Price Index (RPI) plus a half a percent each year. Despite the fact that the formula does not mention cuts at all, the Government says it's being generous by limiting cuts to 2% against a Treasury predicted RPI of minus 3% for this September.
>
> "It means they'll save about £109 million on housing benefit," said Mr Orr. "But against a spend of almost £16 billion a year this is marginal. For the 40% of tenants who pay their own rents the average saving would be about £1.36 a week. But, the majority of tenants we've spoken to would rather keep their services and see new homes built than have reduced rents.[28]

[28] NHF Press Release, 18 August 2009

2. The Coalition Government

2.1 Rent setting 2011-12

The final Housing Revenue Account Subsidy determination for 2011-12 was issued in January 2011. The accompanying letter to local authorities provided an explanation of rent setting policy for 2011-12:

> Rents and Rent Restructuring - Average 6.8% guideline rent increase for 2011-2012
>
> The rent convergence policy – together with a formula for setting annual council and housing association rent increases – was introduced in the early 2000's with the aim that local authority and housing association tenants will eventually pay similar rents for similar properties in similar areas. At the time, it was thought this would take around 10 years to implement.
>
> Ministers have decided to stay with rent convergence policy and to use the existing formula to determine the average guideline rent increase for 2011-2012. The rent increase has, therefore, been established according to RPI inflation at September 2010, which was 4.6%, combined with a factor for convergence. The Determination is based on convergence within 5 years, a measure which gained support in consultation responses. A 2015-2016 convergence timeframe is consistent with the Department's work on self-financing.
>
> These inflation and convergence factors have been used to calculate 2011-2012 guideline rents, and have resulted in a national average increase of 6.8%. The Department has considered all representations received during consultation on the draft HRA Subsidy Determination. Our conclusion is that the 6.8% average guideline rent increase should be confirmed.[29]

In November 2010 the Tenant Services Authority confirmed a guideline rent increase for housing associations of 5.1% in 2011-12.[30]

2.2 Self-financing for local authority HRAs April 2012

The then Housing Minister, John Healey, issued a Written Ministerial Statement on 30 June 2009 in which he announced an intention to publish a consultation document on the reform of council housing finance before the summer recess. He said that there was an "intention to dismantle the HRA subsidy system and replace it with a devolved system of responsibility and funding." The consultation paper, Reform of council housing finance, was published on 21 July 2009.

The consultation paper did not propose any changes to rent setting policy for local authorities but stated:

> It will be necessary to establish long term rent policy in advance of implementing any changes to the system for financing council housing. But we expect to deal with future council rent policy separately, in the context of the HRA subsidy determination for

29 DCLG, HRA Subsidy Determination 2011-12
30 http://www.tenantservicesauthority.org/upload/pdf/Rents_2011-12.pdf (link no longer operational)

> 2010-11 and a future direction by the Secretary of State to the Tenant Services Authority on council rents.[31]

The analysis of rents carried out as part of the review was published alongside the paper.[32]

On 25 March 2010 John Healey issued a statement on the future of council housing finance. He said that the system of self-financing set out in the Reform of council housing finance had received "strong support;" he announced the publication of detailed plans for local self-financing and management. He confirmed the detailed principles and terms on which the Labour Government intended to base self-financing, this included the proposal that rental income assumed in the calculation of a local authority's debt would be based on current rental policy. Full details of the proposals were set out in the DCLG prospectus, Council housing: a real future.

After taking office the new Housing Minister, Grant Shapps, confirmed that the Coalition Government would continue with the consultation exercise started by the previous administration and, in October 2010, he confirmed that the HRA subsidy system would be scrapped and replaced.[33] On 13 December 2010 he set out, in a Written Statement, further details of the basis on which the Coalition Government intended to implement reforms to council housing finance – this statement included confirmation of the intention to continue with existing social rent policy.[34]

Provisions to enable the move to self-financing system for local authorities were included in the *Localism Act 2011*.[35]

The draft HRA determinations for the implementation of self-financing from April 2012 were published for consultation in November 2011. The section on assumed rental income is reproduced below:

> *Assumed rental income*: As described in both the February and July 2011 policy documents, national social rent policy is that rents in the council housing sector should converge with those charged by housing associations by 2015-16, followed by rent rises at RPI + 0.5% per year after this, in line with housing associations. In valuing each local authority's housing business we have assumed adherence to this rent policy.
>
> In keeping with previous years, we will base next year's rent rises on RPI inflation in the previous September, combined with a convergence factor to reflect the number of years to rental convergence with the housing association sector.[36]

2.3 **Rent setting 2012-13**

The Retail Price Index (RPI) for September 2011 reached 5.6%. Applying the DCLG formula of RPI + 0.5% + up to £2 per week, depending on

31 DCLG, Reform of council housing finance, July 2009
32 The full analysis can be found in Analysis of rents for the review of council housing finance
33 DCLG Press Release, 5 October 2010
34 HC Deb 13 December 2010 WS
35 See Library Research paper 11/03.
36 DCLG, Draft HRA determination, November 2011

how close council rents were to target rent levels, meant that council tenants faced rent rises of around 8% from April 2012.

A survey carried out by *Inside Housing* reported that just four of the largest 50 social landlords were planning not to implement the full increase.[37] While local authorities are free set their own rent levels under the principles of self-financing, their inherited debt level is also determined by the DCLG rent formula. So if a council chooses not to apply the formula it could face problems in servicing its debt. Some authorities were reported to have written to DCLG to express concerns about the level of rent increases that their tenants were facing. Harriet Harman raised the impact of the RPI on rent increases for tenants of Southwark Council in December 2011:

> **Ms Harman:** To ask the Secretary of State for Communities and Local Government what assessment he has made of the merits of taking steps to mitigate the effect of the level of the retail prices index on rent levels for local authority tenants in the London Borough of Southwark.
>
> **Andrew Stunell:** No such assessment has been made in respect of the London borough of Southwark. Under existing social rent policy, to protect tenants from large annual rent rises there is a limit on actual rent increases for all individual local authority tenants of retail prices index inflation + 0.5% + £2. This rent policy was introduced under the last Administration.[38]

Steve Partridge, director of financial policy at the Chartered Institute of Housing (CIH) reportedly urged councils to apply the full rent increase on the basis that it would be difficult to make up the difference in future years under the self-financing regime.[39]

The Tenants Services Authority published guidance on the 2012-13 rent setting process for housing associations in November 2011 in which it confirmed a guideline rent increase of 6.1%.[40]

2.4 Rent setting 2013-14

The Retail Price Index for September 2012 fell to 2.6%, its lowest level since December 2009. As a result, local authority tenants faced maximum rent increases for 2013-14 of 3.1%, plus or minus up to £2 a week under rent convergence rules.

A survey of the 25 top stock-owning councils conducted by *Inside Housing magazine* found that only 3 intended not to impose the maximum rent increase in 2013-14:

> The vast majority of council tenants will face rent hikes of between 4.5 per cent and 6 per cent.
>
> The average increase will be 5.1 per cent, according to a survey carried out by Inside Housing.

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[37] *Inside Housing,* "Tenants face 8% rent hike," 13 January 2012
[38] HC Deb 1 December 2011 c1030W
[39] *Inside Housing,* "Tenants face 8% rent hike," 13 January 2012
[40] http://www.tenantservicesauthority.org/upload/pdf/Rents_2012-13_full.pdf (link no longer operational)

> Of those councils with at least 20,000 homes, just Lambeth, Leicester and Nottingham councils have elected not to apply the maximum increase possible.[41]

The regulator published guidance on rent increases for housing associations in December 2012:

> The rent influencing regime commenced on 1 April 2002 and specified a 10 year implementation period. The restructuring of social rents should therefore have been broadly complete by 31 March 2012, unless agreed with the regulator. This means that social rent levels should not be in excess of 5% above target rent levels, subject to the maximum rent caps. However, where such rents are below 105% of target levels an amount up to £2 per week, in addition to the guideline limit, may still be applied until that limit is reached.
>
> Supported housing social rents were allowed an additional year to achieve rent restructuring and also are permitted a tolerance of 10% over target rent levels. The restructuring of rents for this category of properties should therefore be broadly complete by 31 March 2013.[42]

2.5 A ten year rent settlement from 2015

Housing commentators had emphasised the need for clarity on how social housing rents would be set in future as the date for rent convergence drew nearer:

> Changes in policy and funding for affordable housing have created uncertainty about the future of rents and rent setting. The current dual system – rent restructuring and Affordable Rent – may be subject to further changes following the Pay to Stay proposal. The affordable housing sector and government needs to debate and agree how all sub-market rents will be set in future in particular as we get closer to the end of the restructuring regime (2011/12 for housing associations and 2015/16 for local authorities). The nature and coherence of the approach is particularly important for financial planning but it also affects the fundamental purpose and objectives of sub-market housing.[43]

The Chartered Institute of Housing (CIH) and L&Q housing association published a joint report in September 2012 which looked at options for more flexible approaches to rent setting: Future options for rents and rent setting. The report called for:

- an agreed measure of affordability;
- an approach to rent setting that will not increase Housing Benefit expenditure;
- an approach that will sustain lender confidence (investment) in the sector – keeping the link with RPI;
- a coherent and stable approach to rent setting;
- clarity around what new rental income can be used for; and
- clarity on the relationship between market and sub-market rents.

The report also (briefly) considered the options of regional rent setting and redistributive rents.

41 *Inside Housing*, "Councils to increase rents by 5.1% on average," 15 March 2013
42 Guideline rent limit for private registered providers 2013-14, December 2012
43 CIH/L&Q, Future options for rents and rent setting, September 2012

The Government confirmed its intention to provide clarity over future rent setting policy during the 2013 Budget announcement and, as part of the 2013 Spending Round, announced that "from 2015-16 social rents will rise by CPI plus 1 per cent each year for 10 years."[44] The Spending Review document stated that the Government would save £540 million in 2017-18 as a result of the change in formula.

Housing organisations welcomed the certainty delivered as a result of this announcement but some concerns were expressed over whether the change in formula would reduce landlords' incomes and thus have an impact on their ability to invest in existing and new homes.[45] Matthew Warburton, Policy Adviser to the Association of Retained Council Housing (ARCH), provided the following assessment of the implications of the formula change:

> It is generally accepted that CPI will rise more slowly than RPI, since it does not include housing costs, but by how much is debatable. Between 1989 and 2011 the average annual rise in CPI was 0.7% less than RPI, although in 2009-10 the relationship was reversed, with CPI over 3% more than RPI.
>
> A deeply technical paper published by the OBR in 2011 argues that the future gap is likely to widen to a long run average of 1.4%. If this is true, the long run effect of the new formula would be a cumulative reduction in rent income by 0.9% a year compared with current business plan assumptions, with a significant impact on the scope for new building. However, the composition of CPI is due to be reviewed, putting a question mark over any long run prediction.[46]

Modelling carried out by the Chartered Institute of Housing also indicated that landlords would experience some loss in rental income as a result of the formula change compared to what they would have received if the existing system had been extended:

> This could of course affect their ability to invest, for example in developing new affordable housing, however the extent of this will depend on what assumptions they had previously made in their business plans about future rent increases.[47]

The end of convergence

While social landlords were still digesting the implications of the formula change DCLG sent a letter to housing bodies on 2 July 2013 in which plans to cut short the policy of converging council and housing association rents were revealed:

> Having considered the issue carefully, we are minded not to extend rent convergence beyond 2014-15 – and the policy costings published by the Office for Budget Responsibility are based on that assumption. So when we say rent increases of up to CPI + 1% from 2015/16 onwards, that is what we mean.
>
> We expect most landlords to have achieved rent convergence by 2015. By that point, rent convergence policy will have been in place for almost 15 years – this is a significant period of time for

44 Treasury, *Investing in Britain's Future*, Cm 8669, June 2013
45 *Inside Housing,*" Rent changes to save Treasury £1bn", 26 June 2013
46 ARCH, The new rent formula – what does it mean, 27 June 2013
47 CIH Briefing on rent setting from 2015, 2013

> landlords to make full use of the rent flexibilities the Government has provided, and most have done so.
>
> We will set out details on limit rents for local authorities in 2014/15 in due course.
>
> In coming to a decision on our future rent policy, we have struck a balance between protecting tenants – ensuring rents remain affordable – and giving social landlords the income they need to invest in new housing (helping more people in housing need) and provide good services to their tenants. We think CPI + 1% strikes the right balance and represents a good deal for both landlords and tenants.[48]

The Draft Local Authority Rent Guidance: Rents for social housing from 2015 to 2016: consultation was published in October 2013 with a summary of responses published in May 2014 (discussed on page 22 of this note). Alongside the consultation paper, DCLG published Guidance on rents for social housing: draft for consultation and Direction on the rent standard 2013: draft for consultation. It was proposed to use powers in section 197 of the Housing and Regeneration Act 2008 to issue a new direction to the regulator[49] on rent.

For landlords owning properties that had not reached their target rent (the optimum rent they should be charging based on a valuation rent formula) the end of rent convergence (i.e. the ability to change social rents by a further +/- £2 per week from 2015-16) was predicted to result in a loss of rental income:

> The end of rent convergence will not affect all organisations, the vast majority of social rented homes are now 'converged', but could have a greater impact on those whose rents are currently still significantly below target level. For example for an organisation managing 10,000 homes, a loss in rental income of £2 per week on each property would equate to over £1m in a single year. The effect will be particularly substantial for organisations whose business plans currently assume a rent increase of this type for several years beyond 2014-15.[50]

The worst affected councils were, reportedly, in high value areas such as London where the gap between target rents and average rents is highest. There were concerns that some local authorities would have to rewrite their 30 year business plans (prepared as a result of the move to self-financing in April 2012) and that the loss in rental income would challenge their ability to repay debt taken on as part of the move to the new financial regime. An article in *Inside Housing* provided an indication of the potential impact for certain landlords:

> Southwark Council has been particularly badly hit. The 40,000-home borough took on £323 million of debt under the HRA reforms and is repaying £80 million a year. It has an 8 per cent gap between target rents and average rents. According to Ian Wingfield, deputy leader at Southwark, 55 per cent of the south London borough's homes won't have achieved rent convergence by 2015 - despite having instigated the maximum increases every year. The council's HRA 30-year business plan had been

48 DCLG letter to the Association of Retained Council Housing, 2 July 2013
49 The Regulation Committee within the Homes and Communities Agency.
50 CIH Briefing on rent setting from 2015, 2013

> predicated on the assumption that convergence would be extended and that rents would continue to be linked to the retail price index. This means Southwark now faces a potential black hole in its business plan of between £300 million and £430 million.
>
> 'This will impact our ability to pay as much [debt] as we can now,' says Mr Wingfield. 'It will hit our housing services. We will have to revise our plans in terms of what we can pay.'[51]
>
> [...]
>
> Bolton at Home has 12,000 homes that will be charging below target rents by 2015. As a result, according to Edward Mellor, assistant director of finance at the 18,000-home association, it faces a £2.5 million-a-year loss in income that will make it struggle to repay its £4.5 million debt without a 'significant' overhaul of its business plan. The CLG says in cases like this, associations should contact the regulator which can grant waivers to the rent standard for extreme cases where an association's viability is threatened.
>
> 'It's a big problem for us,' says Mr Mellor. 'The HCA has asked us to model what the impact will be. Two thirds of our properties are affected, and over 30 years it is a huge loss. I can't see how we could continue making debt repayments.'[52]

July 2013 saw reports of a 'threat' to Southwark Council's plans to build 10,000 new homes.[53]

The financial viability of housing associations' business plans in London was not expected to be affected but some expected a reduction in their capacity to develop:

> Several of the older associations argue the loss in income is going to reduce their capacity to develop homes. Peabody is one such example. As a legacy of its historically low rents, around 40 per cent of its 20,000 homes will not have converged by 2015. As a result, the weekly rent on the average home is £9.74 below target rent, equating to a £7 million-a-year rent loss.
>
> Steve Howlett, chief executive at Peabody, says the 150-year old association would be forced build 100 fewer homes a year as a result of the change. 'This is not a financial issue for us, but it means we will have to build fewer homes. This is more bad news for the government than us.'
>
> Similarly, 57,000-home Affinity Sutton has 5,000 homes that are below target rent, equating to a £19 million rent loss over 10 years. Meanwhile, 21,000-home Family Mosaic has around 9,500 properties affected, and 48,000-home Hyde Group will have around 6,000 below target by 2015.[54]

The Draft Local Authority Rent Guidance: Rents for social housing from 2015 to 2016: consultation acknowledged the impact that the ending of rent convergence may have on some landlords:

> We recognise that this policy change will impact more significantly on some landlords than others. In general, we expect that it would not impact on a landlord's financial viability. But where a

[51] *Inside Housing*, "Missing the Target", 19 July 2013
[52] Ibid.
[53] *Inside Housing,* "Southwark's 10,000 new homes plan under threat", 19 July 2013
[54] Ibid.

> private registered provider believes that any aspect of our new policy will impact on their financial viability, they should contact the Regulator, which can offer time-limited waivers from adherence to policy to support associations to remain financially viable. Before providing a waiver, the Regulator expects an association to have looked at all other solutions for addressing their viability concerns, including reducing non-core spending.[55]

The fact that there was no reference to 'waivers' for local authority landlords led some to describe the approach as 'unfair.'[56]

One response to the Government's announcement appeared to be the imposition of maximum rent rises by social landlords in 2014-15:

> Councils are planning inflation-busting rent hikes in an attempt to plug multi-million pound holes in their business plans caused by proposals to change rent-setting rules.
>
> Exclusive Inside Housing analysis of the business plans of more than 40 English councils reveals that the majority will apply the maximum rent increases allowed in 2014/15. The average increase will be 5.16 per cent. They are doing this to minimise predicted losses of hundreds of millions of pounds over their 30-year business plans as a result of an early end to the government's policy to align social housing rents.
>
> Twelve councils expect combined losses of £603.7 million over the next 30 years.
>
> Leeds Council estimates rental losses of £179 million, while Barnsley and Dacorum councils each predict a £100 million loss.
>
> Welwyn and Hatfield Council said the changes would cost it 'tens of millions of pounds' and that it would 'leave a totally unsustainable HRA within five years'.
>
> As a result the authority is deviating from the rent guidance and increasing rents by 7.22 per cent in April. It will continue to increase rents significantly in 2015/16 and 2016/17.
>
> Around 25 councils are warning that because much of their stock will not have met 'target rent' by 2015/16, they will face losses in income that threaten the viability of their housing revenue account business plans, ability to build homes and deliver services.
>
> Under government plans, from April 2015 councils will no longer be able to increase rents gradually by £2 until they meet optimum, known as target rent. This means 2014/15 is the last year they can use the formula of the retail price index (3.2 per cent) plus 0.5 per cent, plus up to £2 per week. Instead, for the next 10 years rents will be set using the consumer price index plus1 per cent.
>
> In Kensington and Chelsea, where just 34 per cent of homes will have reached target rent, the council plans to hike rents by 6.28 per cent in 2014/15. It will continue increases outside the guidance formula for the next five years.[57]

On 7 February 2014 Inside Housing reported that 95% of housing associations would increase their rents in 2014-15 by the maximum

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[55] DCLG, *Rents for social housing from 2015 to 2016: consultation,* October 2013, para 47
[56] *Inside Housing,* "CLG under fire over rent plans," 8 November 2013
[57] *Inside Housing,* "Rent plan blows hole in council coffers," 24 January 2014

3.7%. Where rents had yet to meet target levels associations could add up to £2 per week.[58]

The Government published a summary of responses to its consultation process in May 2014.

Around 40% of respondents were strongly opposed to the proposals, specifically the end of rent convergence, with some landlords stating that they had not been able to reach full rent convergence due to historically low rents:

> Their main objection was to the end of rent convergence. Their main concern related to the potential loss of income arising. Some landlords were also concerned that it would lead to differential rents between existing and new tenants.[59]

Concerns were also specifically raised about the removal of the additional £2 to facilitate rent convergence, and that this was not in line with the calculations underpinning the Housing Revenue Account self-financing settlement:

> The key concerns expressed related to the removal of the flexibility available to landlords to increase social rents each year by an additional £2 above the increase in formula rent, where the rent is below the rent flexibility level and rent cap (what is known as rent convergence policy.
>
> […]
>
> A number of local authorities and representative bodies said that the removal of the £2 flexibility was not in line with the calculations underpinning the Housing Revenue Account self-financing settlement. They said this would result in a loss of rental income which could affect their business plans. Some also said that they were concerned that this policy change had been proposed so soon after the start of self-financing [60]

Responses from tenants were mixed. Although tenants wanted to limit rent increases, they also expressed concern about the impact of ending rent convergence and the impact this would have on landlords' ability to pay for services and investment in new housing.

Some concerns were also raised about the use of CPI, rather than RPI, for calculating rent increases:

> Around one-fifth of respondents disagreed with this aspect of the policy, the majority of which were local authorities. They felt that the move from RPI to CPI has the potential to result in lower rent increases in the long term, as CPI has tended to be lower than RPI. If this is the case, they argued it would result in providers being able to generate less money from rent increases, with a negative impact on Housing Revenue Accounts over 30 years.[61]

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58 *Inside Housing,* "Majority of associations to hike rents by maximum," 7 February 2014

59 Department for Communities and Local Government, Rents for Social Housing from 2015-16, Consultation: Summary of Responses, May 2014, para 3.4

60 Department for Communities and Local Government, Rents for Social Housing from 2015-16, Consultation: Summary of Responses, May 2014, para 3.19

61 Ibid.

Guidance on social housing rents from April 2015

Local authorities

In May 2014, the Government published its final policy on rents for social housing for ten years from April 2015 - Guidance on rents for social housing. The guidance applies only to local authorities, although the Social Housing Regulator is expected to have regard to it when setting the Rent Standard for private registered providers (see below). The guidance replaces the 2001 Guide to Rent Reforms and A Guide to Social Rent Reform in the Local Authority Sector (2003) "and any other guidance on rents issued in relation to those documents."[62]

The Government's guidance confirmed it would proceed with its policy of abolishing the provision for landlords to increase rents by an additional £2 per week to achieve convergence. It also confirmed the introduction of a CPI-linked calculation on which local authorities were expected to set their rents from April 2015 onwards:

> From 2015-16 to 2024-25, the uplift for each year should be the Consumer Price Index (CPI) at September of the previous year plus 1.0 percent.[63]

The guidance allowed for some flexibility to set rents above the standard calculation to maintain financial viability for local authorities:

> As a result, the policy contains flexibility for authorities to set rents at up to 5 percent above formula rent (10 percent for supported housing and sheltered housing). We expect authorities to use this flexibility in a balanced way, and not set all rents at 5 percent (or 10 percent) above the formula rent.
>
> Where a rent is at a level that is more than 5 percent (or 10 percent) above the formula rent in 2015-16, it should be brought within the flexibility level over time, either through applying a rent increase of less than CPI + 1 percentage point, or through lowering the rent when the property becomes vacant and is re-let. In terms of lower rent increases, we expect this to be done in a way that brings the rent within the flexibility level within a reasonable period of time, whilst ensuring financial viability is maintained.[64]

Registered providers/housing associations

The Government issued a new Direction on the rent standard 2014 in May of that year which applies to standards set by the Homes and Communities Agency (HCA) in relation to rents for registered providers from 1 April 2015. The HCA then published Consultation on Changes to the Regulatory Framework: Annex 3. The Rent Standard in May 2014. This document:

> …replaces that which took effect from April 2012. The previous version had consolidated all of the previous guidance first issued by the Housing Corporation and adopted by its successor social housing regulator bodies. It is guidance issued in relation to the

62 Department for Communities and Local Government, Guidance on Rents for Social Housing, May 2014
63 Department for Communities and Local Government, Guidance on Rents for Social Housing, May 2014
64 Ibid.

> requirements of the Rent Standard that applies from 1 April 2015.[65]

The consultation period ended on 19 August 2014. Subsequently, in July 2014 the Government published Supplementary Guidance on the Rent Standard which contained additional guidance on the process for waiver applications ahead of 1 April 2015 to enable landlords to determine their rent levels before that date.

Comment

The National Housing Federation welcomed the certainty provided by the Government's ten year policy, but again raised concerns about the end of rent convergence:

> The Federation welcomes the certainty this settlement affords to housing associations in planning their business. However, we were disappointed that the Government persisted with the decision to abolish rent convergence, despite significant opposition…
>
> We have expressed concern over the impact the proposals will have on the business plan of members, including in some cases the risk of financial viability.
>
> There appears to be few housing associations falling into this category and the Homes and Communities Agency (HCA) has agreed to consider a waiver to convergence for those associations but only in a very narrow set of circumstances and only after all other options have been exhausted:
>
> to ensure ongoing viability
>
> to ensure covenant compliance and
>
> to ensure delivery of transfer promises in early years' Large-Scale Voluntary Transfers (LSVTs).[66]

In October 2014, *Inside Housing* also reported that, due to record low inflation rates with the CPI set a five year low of 1.2% in September 2014, landlords would only be able to increase rents by up to 2.2%. This is 0.6% lower than if the RPI linked system had been retained. Commentators predicted a heavy knock-on effect for housing organisations:

> People will have to make serious cuts and improvements in value for money if they are to continue operation. For some organisations the effect will be severe.[67]

[65] HCA, Consultation on Changes to the Regulatory Framework: Annex 3. The Rent Standard, May 2015

[66] Department for Communities and Local Government, Guidance on Rents for Social Housing, May 2014

[67] *Inside Housing*, 'Rents will be "squeezed" as inflation falls, 17 October 2014

3. Summer Budget 2015: reducing rents by 1%

As part of the Summer Budget 2015 the Chancellor announced that rents in social housing would be reduced by 1% a year for four years resulting in a 12% reduction in average rents by 2020-21:

> Alongside the freeze in working-age benefits, the government will reduce rents in social housing in England by 1% a year for 4 years, requiring Housing Associations and Local Authorities to deliver efficiency savings, making better use of the £13 billion annual subsidy they receive from the taxpayer. Rents in the social sector increased by 20% over the 3 years from 2010-11. This will allow social landlords to play their part in reducing the welfare bill. This will mean a 12% reduction in average rents by 2020-21 compared to current forecasts.[68]

The 'subsidy' referred to in this extract refers to the personal entitlement to Housing Benefit of 2.7m social housing tenants. The measure is forecast to save £1.4bn by 2020-21, primarily in reduced Housing Benefit expenditure.[69] Around 1.2m tenants not in receipt of Housing Benefit in the social rented sector are expected to benefit by £700 per year (current prices)[70] although some of these tenants may, in due course, be required to pay market (or near market) rents if they earn £30,000 or more (outside of London) or £40,000 or more (within London).[71]

The 2.7m tenants in receipt of Housing Benefit in social housing will not gain from lower rent levels but the Institute for Fiscal Studies (IFS) notes that work incentives for this group could be improved.[72]

Measures have been included in the *Welfare Reform and Work Bill 2015-16* (currently progressing through Parliament) which will require social landlords to reduce the rents payable by individual tenants by 1% each year between 2016 and 2019. The rent baseline will be the rent payable on 8 July 2015, although the Secretary of State will be able to consent to an alternative 'permitted date.'

Regulator of Social Housing will be given the power, by direction, to exempt a private registered provider from the rent reduction requirement. An exemption will only be granted where compliance with the requirement would jeopardise the provider's financial viability.

Similarly, the Secretary of State will have power to issue a direction to exempt a local authority from the rent reduction requirement if he considers that compliance would result in the authority being unable to avoid serious financial difficulties.

68 Summer Budget 2015, HC 264, July 2015, para 1.140
69 Ibid., Table 2.1 p.73
70 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015
71 See section 5 of this paper.
72 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015

Comment

Housing associations have been proactive in seeking out alternative sources of funding. They have, in large part, been successful in doing so due to investors' assumption of a steady rental income – this has also enabled associations to borrow at a reasonable rates to invest in new housebuilding. In A Plan For Homes, launched on 13 July 2015, the National Housing Federation (NHF) called on the Government to offer, inter alia, greater flexibility in setting rents within an overall envelope in order to achieve "genuinely affordable rents while creating the most effective income stream." With this and other measures, the NHF claimed that associations could develop 120,000 new homes per year.[73]

In this context, the requirement to reduce social housing rents was unexpected, particularly as the ten-year rent policy (to operate from 2015-16) had been announced in May 2014 with a stated intention of enabling social landlords to plan for future investment:

> At Budget 2013, the Government signalled its intention to set out, in the Spending Round, a rent policy to apply for ten years from 2015-16. This commitment was in recognition of the benefit of long-term certainty to landlords, in helping them to plan for future investment – and so provide more new affordable homes, improve existing affordable homes, and provide good services to their tenants.[74]

Development of affordable housing

The announcement has been greeted with some dismay by social landlords who are now modelling the impact on their business plans. The Office for Budget Responsibility (OBR) is predicting a reduction in housing investment as a result of the measure:

> …the 1 per cent a year reductions in social sector rents for four years from April 2016 announced in this Budget will directly reduce social landlords' rental income. We expect that this will reduce their ability and willingness to invest in housing, so we have lowered our forecast for residential investment, proportionate to the expected reduction in rental income. The effect is to reduce the level of private residential investment by around 0.7 per cent by the end of the forecast period, which is broadly consistent with a reduction in housebuilding of 4,000 in 2020-21. Over the forecast period, our assumptions suggest around 14,000 fewer affordable homes will be built. We do not expect private sector house-builders to offset this effect to any material degree.[75]

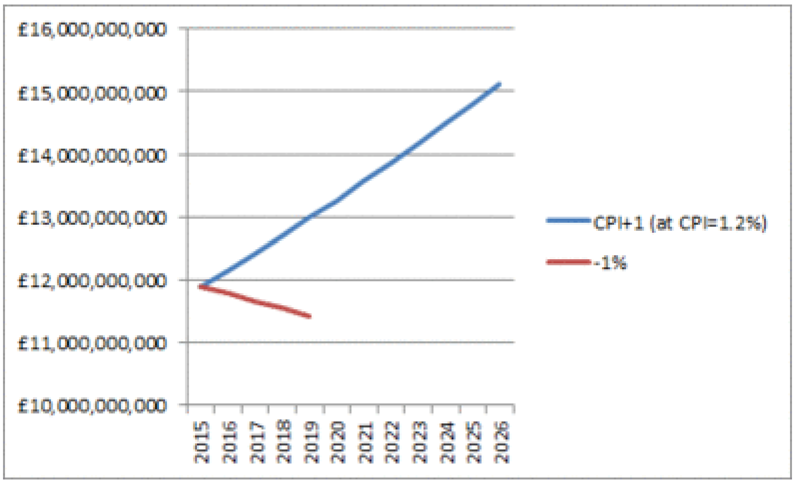
The National Housing Federation is estimating a more significant reduction in development:

> Our own estimates suggest that the reduction will result in a loss of almost £3.85bn in rental income over the four years. Simply dividing this by the average build cost in the 2011-15 programme of £141,000, suggests that at least 27,000 new affordable homes won't be built as a result of the change. This of course assumes the lost income wouldn't be matched by any government grant or

73 A Plan For Homes, NHF, 13 July 2015
74 Guidance on rents for social housing, DCLG, May 2014, para 1.10
75 OBR, Economic and Fiscal Outlook, Cm 9088, July 2015, para 3.84

> used to leverage in private finance, so the actual total could be higher.[76]

The table below prepared by the NHF illustrates the forecasted impact of the Budget announcement compared with the rental income expected under the CPI + 1% regime. The cumulative loss to the sector's total rent revenue is estimated at around £3.85bn over the four years to 2019/20 (assuming CPI of 1.2% per year).



The Local Government Association (LGA) has carried out modelling on the impact of rent reductions for councils with retained housing stock and concluded that the measure will cost councils £2.6 billion by 2019/20:

> The cost to councils will rise from £234 million in year one, to £508 million in year two, £795 million in year three, and over £1 billion by 2019/20. By that point the annual funding gap will represent 60 per cent of local government's total housing maintenance budget. Over the four years the total £2.6 billion will be equivalent to the cost of building almost 19,000 new homes.[77]

The withdrawal of the ten-year approach to rent setting has, according to affected landlords, resulted in a lack of confidence in the sector which, in turn, could affect credit agencies' confidence.[78] The rating agency for 44 social landlords, Moody's, has reportedly said that the measure has had an adverse impact on the sector's traditional stability:

> The agency said: 'A traditional credit strength of English [housing associations] has been the predictability of the policy environment and the sector's strong ties to government. This stability has been eroded by the sudden removal of the rent-setting formula, which was preceded by limited consultation…
>
> 'In the past, Moody's has viewed the sector's close relationship with government as credit positive due to a settled and supportive policy environment. This is no longer the case, with changes in

[76] Summer Budget 2015 Briefing, National Housing Federation (NHF), 10 July 2015
[77] LGA Press Release, 21 July 2015
[78] "Scrapping of rent formula to reduce building," *Inside Housing*, 10 July 2015

> government policy creating a more challenging operating environment for [housing associations].'[79]

The overriding concern of housing commentators is that the potential adverse impact on housing development comes at a time when there is a general consensus over the need for additional housebuilding to tackle the UK's housing shortage and associated affordability issues. While supporting the Government's aim of reducing expenditure on Housing Benefit, social housing providers and their representative bodies believe that this is best achieved through increasing housing supply, rather than by reducing their rent levels and restricting access to housing support. Responding to the Summer Budget, Terrie Alafat, CEO of the Chartered Institute of Housing (CIH), said:

> Action to restrict entitlement to benefits is at best a stop gap measure and at worst increases poverty and misery for already poor and vulnerable people. Long-term, effective action would focus on increasing our housing supply not further restricting access to our already insufficient and inadequate supply of homes.
>
> Cutting housing benefit simply penalises people who are struggling to afford a place to live, rather than tackling the root cause of the problem. Freezing working age benefits for four years fails to reflect the reality of the housing crisis – we have failed to build the number of homes we need for decades, which means the cost of housing and therefore the housing benefit bill is going up.
>
> We know the government wants to tackle this issue, and housing professionals across the UK are ready to work with them on the solutions that could make a real difference. But we're concerned that some of the measures announced today are going to make it more difficult for them to play their part in building the new homes we need and supporting people into work or training.
>
> Social landlords built almost 60,000 homes in 2014/15 and have also made significant investment in employment and training support. We understand the government's desire to manage the cost of the housing benefit bill – but undermining their income by cutting social housing rents by one per cent a year over the next four years is going to make it much tougher to build new homes at a time when we desperately need to do so.[80]

There have been reports of housing associations seeking to renegotiate their development plans under the Affordable Homes Programme with some seeking to develop more homes for sale instead of sub-market rented homes.[81]

To date, there has been little reference from the sector to the Government's aspiration that the policy's impact should be absorbed through efficiency measures rather than cuts to development programmes.

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79 "Moody's: Rent cut could cost sector 7% in revenue," *Inside Housing*, 13 July 2015
80 CIH responds to the Summer Budget 2015, 8 July 2015
81 "Affordable homes programme renegotiated as rent cuts bite," *Inside Housing*, 6 August 2015

Potential reclassification of housing associations

The Government's announcement of an intention to extend the Right to Buy to assured tenants of housing associations[82] had already raised questions around the ongoing status of associations as private not-for-profit businesses. This, together with the rent reduction policy, has led the OBR to identify a risk of housing associations being reclassified as public sector bodies with consequent implications for the treatment of their debt:

> The level of PSND can be affected by classification decisions that move institutions across the boundary between private and public sectors in the National Accounts. One classification uncertainty that may be relevant to future forecasts relates to housing associations. At present, these are classified in the private sector, so their income, spending and debt do not feature in our forecast. But there is a risk that Government policies – including the social rent measure in this Budget and the Right-to-Buy proposals that are not yet firm enough to be included in this forecast – could prompt the ONS to reconsider this classification. If housing associations were to be classified as part of the public sector, their approximately £60 billion of debt would be added to PSND while the social rent reduction policy announced in this Budget would increase rather than reduce PSNB because the full amount of the rent reduction would then reduce public sector income, and outweigh the housing benefit and other expenditure savings.[83]

82 Measures are expected to be included in a forthcoming *Housing Bill*.
83 OBR, Economic and Fiscal Outlook, Cm 9088, July 2015, para 1.30

4. Affordable rents

The Coalition Government announced an intention to introduce a new "intermediate rent" tenure as part of the October 2010 Spending Review. Under this model housing associations can offer tenancies at rents of up to 80% of market rent levels within the local area. The additional finance raised is available for reinvestment in the development of new housing. Detailed information on affordable rent tenure can be found in Library briefing paper 05933.

The then Housing Minister provided some additional information in a Written Statement on 9 December 2010 - he clarified that the rent restructuring policy would not apply to properties let at affordable rents:

> Affordable Rent properties will not be subject to the rent restructuring policy that applies to social rented housing. This policy was originally outlined by the previous government in March 2001 (in the *Guide to Social Rent Reforms*) and implemented by the then Housing Corporation (via the *Rent Influencing Regime Guidance* published by the Corporation in October 2001). The previous government's direction to the Tenant Services Authority issued in November 2009 required the regulator to set a standard on rent that reflected the same policy.
>
> In particular, the direction required the Tenant Services Authority, when setting a standard on rents, to have regard to the Social Rent Guidance. The direction defined the term 'Social Rent Guidance' as the *Guide to Social Rent Reforms* published in March 2001 "*and any guidance issued by the Department, or its successors, in relation to that document*." This statement should be treated as guidance issued in relation to the March 2001 document. The direction also obliged the Tenant Services Authority to set a rent standard with a view to achieving, so far as possible, the target rent policy set out in the Rent Influencing Regime Guidance.
>
> This statement clarifies that Affordable Rent properties are not covered by the Government's rent restructuring policy. Note that a property is only considered to be 'Affordable Rent' for these purposes where it is linked to an agreement with the Homes and Communities Agency on investment.
>
> Housing associations will be able to let an Affordable Rent property (whether a converted void or new build) at *up to* 80 per cent of market rent for an equivalent property for that size and location. The association's calculation of the market rent would need to be based on a residential lettings estimate for a property of the appropriate size, condition and area. Valuations should be in accordance with a RICS recognised method.
>
> The maximum annual rent increase on an Affordable Rent property will be RPI + 0.5 per cent. However associations will be required to rebase the rent on each occasion that a new tenancy agreement is issued (or renewed) for an Affordable Rent property. This requirement, which *overrides* the RPI + 0.5 per cent limit, is designed to ensure that the rent set at the beginning of each new tenancy is no higher than 80 per cent of the market rent.[84]

[84] HC Deb 9 December 2010 c31-4WS

The December 2012 rent guidance published by the HCA stated:

> The maximum annual rent increase for Affordable Rent is similarly based upon the September RPI+0.5%, so the limit for 2013-14 is 3.1%.
>
> Details on how Affordable Rent property levels of rent should be set for new and re-issued tenancies are provided in the Rent Standard Guidance.[85]

Guidance on rents for social housing published in May 2014 included a section (3) on rent increases for Affordable Rent properties. Rent increases for these properties were also expected to follow the CPI +1% formula from April 2015.[86]

The requirement to reduce rents by 1% in each year for four years from April 2016 (see section 3 of this paper) will also apply to properties let at affordable rents.

85 Guideline rent limit for private registered providers 2013-14, December 2012
86 DCLG, Guidance on rents for social housing, May 2014

5. 'Pay to stay' at market rents

In June 2012 DCLG published a consultation document High Income Social Tenants: pay to stay in which it proposed an income threshold above which tenants in social housing would be charged higher rents. The Government confirmed that it would implement this policy change as part of the 2013 Budget announcement:

> **1.113** The Government also wants to make sure that affordable housing is available to those who need it most. The Government recently consulted on 'Pay to Stay' proposals to ensure that those social housing households on high incomes make a fairer contribution. **The Government will shortly take steps towards allowing social landlords to charge market rents to tenants with income of over £60,000.** The Government intends to require these tenants to declare their income to ensure they make a fair contribution, with all additional income reinvested in housing.[87]

'Pay to stay' is currently discretionary; social landlords can charge tenants with an income of over £60,000 a market rent. The Guidance on rents for social housing (May 2014) provides details on whose income should be taken into account and what counts as income for the purposes of the pay to stay policy. It is unclear how many, if any, landlords have implemented higher rents for this category of tenant.

As part of the Sumer Budget 2015 the Chancellor announced that the discretionary 'pay to stay' scheme would be made compulsory (in England) and that new, lower, income thresholds would be introduced. These thresholds are expected to be £40,000 in London and £30,000 elsewhere. Local authorities will be expected to repay the additional rental income to the Exchequer 'contributing to deficit reduction' while housing associations will be able to use the additional income to reinvest in new housing.

The move to a mandatory 'pay to stay' scheme will require primary legislation; the Government has said it will consult and set out details, including how income will be calculated for those affected, in due course.

For more information see Library note Social housing 'pay to stay' at market rents (England) (CBP06804).

[87] HC 1033, March 2013

6. Alternative rent models

6.1 **A living rent?**

Funded by the Joseph Rowntree Foundation and the National Housing Federation, Mark Lupton and Helen Collins from Savills Housing Consultancy have developed a rent model linked to household income. The model has reportedly been tested against the business plans of seven social landlords – these tests showed "that the earnings-linked rent model is viable for landlords if it is gradually phased in through relets and supported by subsidy through either grant funding or through government guarantees."[88]

The model is explained in an *Inside Housing* article, A living rent?[89]

6.2 **Rent flexibility for housing associations?**

In November 2014 Chris Walker, for the Policy Exchange think-tank, published Freeing Housing Associations: Better financing, more homes. This report proposes a package of measures aimed at increasing the capacity of associations to develop more housing. As part of the package housing association would gain freedom to develop their own rent policy:

> Under a radical new plan proposed in the paper, housing associations could "opt-out" of their historical government grant which binds them to these rules. A new category of what the report calls 'Free Housing Associations', would buy out their historical grant from the government at a discounted cost in return for the removal of regulatory restrictions. Paying off the government grant would raise significant cash for the Treasury. The report shows that a combination of sale proceeds along with debt interest savings could raise over £300million a year by the end of the next Parliament and as much as £550million a year within 30 years.
>
> The paper makes a number of recommendations for new grant-free housing associations including:
>
> 1. Allowing them to sell off expensive social homes in order to build a greater number of new affordable homes without having to get permission from the Homes and Communities Agency.
> 2. Extending the Help to Buy scheme for new homes beyond 2020 for housing associations to allow them to build more market homes for sale. Profits could be used to cross subsidise affordable homes.
> 3. Allowing them to set their own rent policy. Instead of having a number of different rents for similar properties inhabited by similar households, as dictated by government, grant-free associations could set a single

88 *Inside Housing,* "Social landlords lobby for radical rent model," 19 September 2014

89 *Inside Housing*, "A Living Rent?"30 September 2014 (note that you may need to register with *Inside Housing* in order to view this online).

rationalised rent or cheaper rents to reward good tenant behaviour.

Free Housing Associations could then be free to double the number of new homes built every year from 50,000 to 100,000. Currently housing associations build 45,000 affordable homes and 5,000 private homes every year. The paper expects that number to increase to 60,000 affordable homes and 40,000 private homes if they had more freedom from the regulator, the Homes and Communities Agency (HCA) and local authorities.[90]

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90 Policy Exchange Press Release, 12 November 2014 [accessed 5 January 2015]

BRIEFING PAPER
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