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Briefing Paper

Three-Year Review of Rent Restructuring

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Introduction

The government published its three-year review of rent restructuring in July 2004. This review was intended to consider the operation of the rent restructuring mechanisms rather than as a fundamental review of the policy itself.

The review has concluded the policy is working well but needs some fine-tuning in running the ten-year social rent restructuring programme established in April 2002. However, it has resulted in some interesting proposals for changes to the process.

The consultation period closes on 30th September 2004. Local authorities and housing associations should spend the intervening period assessing the implications of the proposals for themselves and should consider making appropriate representations to the Office of the Deputy Prime Minister.

This briefing paper is intended to assist with this process.

Summary of the Proposals

Over a ten-year period from April 2002, councils and housing associations are being encouraged to set their rents within 5% of the levels given by a national formula that reflects a property size, location and condition. The government's objective is to achieve a structure of social rents where:

- Social rents are affordable and well below those in the private sector
- Social rents are fairer and less confusing for tenants
- There is a closer link between rents and the qualities which tenants value in properties
- Unjustifiable differences between the rents set by local authorities and housing associations are removed

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The government also wants rent restructuring to prepare the way for the extension of reforms to housing benefit to tenants in the social sector. The government intends to pilot a local housing allowance in the social housing sector as soon as practicable.

This will cause similar social tenants renting similar homes in the same area to have very similar rents regardless of their landlord. It will put at end to the pre-2002 situation in which the rents charged by neighbouring councils for similar properties could vary by a third or more, and housing associations could charge over half as much again as councils for similar properties in the same area.

With the reforms, social rents will generally be higher for larger properties in areas of high house prices and earnings – such as London and the South East – and lower for smaller properties in areas of low house prices and earnings such as Northern conurbations.

The government considers that social rents will remain affordable – at well below private sector levels in most areas. Council rents will, on average, increase at only about half the rate at which they went up over the last ten years. Housing association rents will also, on average, increase much more slowly than over the last ten years.

A cap has been set on the weekly rent any social tenant will pay as a result of the reforms, for example £106.60 for a 4-bedroom home in 2004/05. Lower figures apply for smaller properties. Where rents are already higher than this, they should be gradually reduced in real terms. For the small number of properties affected by the safeguard, the maximum increase in future years will be retail price index plus 1% a year.

Social landlords are also expected to ensure no tenant faces a rent increase of more than the retail price index plus 0.5% plus £2 a week a year.

On the introduction of this policy in 2002 it was announced that the implementation of the policy would be reviewed after three years. The remit of the review was to:

- Examine the case for technical modifications to the approach
- Consider the annual rent increases allowed for registered social landlords including the implications for the local authority sector
- Investigate the relationship between rent restructuring and other policies

The review was monitored by a steering group chaired by the Office of the Deputy Prime Minister and including representatives of the Housing Corporation, Local Government Association, Association of London Government, National Housing Federation, Council of Mortgage Lenders, Department for Work & Pensions and Department of Health.

Research was carried out as part of the review that examined the experience of rent restructuring in six local authorities and six housing associations. The research concluded that:

- The case study landlords would remain financially viable after the full introduction of rent restructuring, albeit after implementation of quite severe corrective measures in some cases

- In general the affordability of restructured rents (under the current housing benefit system) should not materially worsen and in some cases will improve.
- Significant compression in rent structures is taking place through rent restructuring
- The current policy framework will not achieve the objective of harmonisation of rents between local authority and registered social landlord sectors by March 2012
- The significant divergences in valuations and target rents from relevant sector averages observed in a minority of registered social landlords warrants investigation and correction before introduction of any local housing allowances to the social housing sector.

The review concluded that the basic policy is sound, and made the following recommendations for technical improvements which are now open for wider consultation:

- Larger Properties – higher bedroom weights for three- and four- bed properties, and new, higher weightings for properties wit five and six (or more) bedrooms
- Harmonisation – from April 2005, using the same formula for restructuring local authority rents as that currently used for restructuring registered social landlords' rents, and adopting the retail price index as the inflation measure used in calculating local authority rent increases
- Implementation – local authorities should ignore the downward limit of retail price index plus 0.5% minus £2 per week on rent changes, in order to achieve restructuring on all properties for which rents need to fall by 2011/2012. The Housing Corporation should also encourage associations to do the same, where their finances permit.

The review steering group calculate that the combined impact of the proposals would increase local authority rents (compared to existing policy) by about 40p per week in 2005/2006, rising to about £2.60 per week in real terms by 2011/2012. Individual tenants will continue to be protected by the policy's limit of retail price index plus 0.5% plus £2 per week on annual rent increases and by the caps on maximum rent levels.

The review steering group concludes that:

- Although the policy is generally working well, the proposed changes to the policy will ensure a fairer pattern of rent differentials between properties of different sizes. They will also simplify the policy by adopting a common formula for all council and housing association properties.
- Social tenants will continue to benefit from rents that are well below what the private sector would charge for similar properties. And the government is committed to ensuring that social housing remains affordable for people on low incomes. Tenants will continue to be protected from large or sudden rent increases.

The Housing Corporation has checked that its policy of Registered Social Landlord target rents increasing each year by the retail price index plus 0.5% remains appropriate. It concludes that the current policy strikes the right balance between encouraging efficiency improvements by housing associations and maintaining the financial sustainability of the sector.

Rent restructuring began for supported housing landlords in April 2003 and has not been covered by this review. It will be considered by the Supporting People stakeholder group, but the government is seeking views on supporting housing rents as part of this consultation.

Larger Properties

The review steering group found concerns that the existing policy was causing excessive compression of the rent differences between properties of different sizes. They found that this was unfair to tenants in smaller properties and gave weak signals to landlords and tenants about the relative attractiveness of properties. They therefore recommended that the 'bedroom weightings' in the rent restructuring formula be increased for three- and four- bed properties.

The review also recommends that new, higher, weightings are introduced for the handful of properties with five and six (or more) bedrooms. They consider that this change would better reflect the relative attractiveness of larger properties to tenants and also improve their financial viability for landlords, encouraging the development of such properties where they are needed. They consider that this would be of particular benefit to specialist Black and Minority Ethnic housing associations that have considerable numbers of these properties.

The three-year review therefore recommends increasing the "bedroom weightings" in the formula to 1.10 for three-bed properties and 1.20 for four-bed properties, and introducing even higher weights for properties with five bedrooms or six bedrooms and over. Rent caps would also be increased in line with the increased weightings.

It is intended that the Office of the Deputy prime Minister will collect stock data broken down by these new bedroom categories in the 2005/2006 base data return. This data would need to be audited and returned by 10th October 2004 in line with the usual timetable for the determination of housing revenue account subsidy.

The government's initial statements on the need for the reform of social rents, prior to the publication of their specific proposals for rent restructuring, referred to the existing rent structures being 'too flat'. The argument was made that there was insufficient difference between the rents of social housing of different types and therefore insufficient incentive for tenants to choose appropriate housing or for landlords to provide it. It was therefore ironic that when the government eventually unveiled its formula for determining social rents it became apparent that it had chosen a formula that would have the effect of compressing differentials between the rents of different types of housing.

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The three-year review has addressed this matter in proposing a higher bedroom-weighting for larger properties. However, it is not clear whether this adjustment to the formula will prove sufficient to introduce the differentials in rents that may be required to provide tenants and landlords with incentives. The introduction of direct payments of housing benefit to tenants as a 'shopping incentive' is relevant here, as for this process to work effectively rent differentials need to be significant.

The existing bedroom weightings were designed to have a neutral effect on the average rent charged as the reduced rents on bedsits and one-bedroom homes balanced the increased rents on homes with three or more bedrooms. By increasing the weighting on homes with three or more bedrooms and leaving the weightings on homes with two or less bedrooms unchanged, the government is increasing the average rent. This would result in increased income to housing associations, but not to local authorities as the increased rents would result in increased guideline rents and therefore reduced housing subsidy. Consequently tenants would pay more and the proceeds in the case of housing associations would flow to the landlord and in the case of local authorities to the government. However, the government proposes to return these resources to local authorities through management and maintenance allowances (see below).

Harmonising the Formulae

The review steering group recommends that local authorities move to the registered social landlords' formula from April 2005 with no phasing and that the retail price index rather than the gross domestic product deflator is adopted in the calculation of annual rent changes for local authority properties.

The review steering group found that by the completion of rent restructuring in 2011/2012 there will be relatively small differences between the rents charged by councils and housing associations for similar properties in the same areas. However, they considered that the different formulae used in each sector have caused confusion and would mean that differences in rents would remain. They concluded that a single formula would bring advantages of simplicity and fairness. They therefore recommended that from April 2005 the same formula would be used for restructuring local authority rents as that currently used for restructuring housing association rents, ensuring harmonisation of rents between the two sectors.

For the same reasons, the review steering group concluded that there appeared to be a case for changing the inflation measure used in calculating annual local authority rent increases to the retail price index, which is already used for housing associations. They consider that on average across the years the change in the inflation measure used for local authorities should have no impact on the scale of rent increases.

The current local authority formula rent (at April 2000 values) is:

Earnings element:	70% x £45.60 x relative county earnings x bedroom weight
Valuation element:	30% x £45.60 x property value / £41,350.
Formula rent;	Earnings element + Valuation element
Where:	£45.60 is the national average council house rent £41,350 is the national average council house value Average rent increases 1.5% a year in real terms

This would change to:

Earnings element:	70% x £54.62 x relative county earnings x bedroom weight
Valuation element:	30% x £54.62 x property value / £49,750.
Formula rent;	Earnings element + Valuation element
Where:	£54.62 is the national average housing association rent £41,350 is the national average housing association value Average rent increases 0.5% a year in real terms

The formula for calculating housing association rents would remain unchanged.

The review steering group consider that these changes would enhance the effectiveness of the policy and be fairer for tenants. They consider that the impacts on affordability would be very modest, although almost all local authority tenants would face slightly higher rent increases because of harmonisation.

As 'harmonisation' has always been one of the important objectives of the exercise, it may be considered inevitable that the government would end the use of different average rents and property values for local authorities and housing associations at some point during rent restructuring. However, the use of the housing association data rather than an average of social housing as a whole will result in an increase in rents for local authority tenants and no change in that for housing association tenants. Again, this increase will be taken account of in determining guideline rents and housing subsidy and so will accrue to the government rather than to the local authority. However, the government proposes to return these resources to local authorities through management and maintenance allowances (see below).

Speed of Implementation

The review steering group was concerned that the limit on annual rent changes severely delays the full implementation of the policy for a minority of properties. They found that in one inner London borough with very high property values, rent restructuring would be complete by 2011/2102 for less than 1% of council properties with two or more bedrooms.

They did not consider that there is a case for relaxing the limit of retail price index plus 0.5% plus £2 a week on annual rent increases for individual tenants. It believes that it is important to provide protection against sudden rent increases.

Instead the review steering group recommends that local authorities ignore the downward limit of retail price index plus 0.5% minus £2 a week on rent charges in order to achieve rent restructuring on all properties for which rents need to fall by 2011/2012. They consider that some housing associations may also be able to reduce rents at a quicker rate where their finances permit.

This is obviously good news for the tenants who are affected. Landlords will see reductions in their rents. In the case of local authorities the guideline rent and housing subsidy will be adjusted so that the impact on the housing revenue account is neutral, but in the case of housing associations this will represent a real loss in their income, hence the exemption where their finances do not permit it.

Management and Maintenance Allowances

The review steering group notes that when rent restructuring was first introduced it was agreed that changes to housing revenue account subsidy to support the policy of rent restructuring should not result in an increase or decrease in the resources available to local authority housing revenue accounts at a national level. This has been achieved by compensating local authorities as a whole (but not individual authorities) for losses in subsidy through making increases in management and maintenance allowances – a process known as 'rebasing'.

The review steering group concedes that the changes now proposed to local authority formula rents will, at a national average level, result in greater increases to guideline and limit rents. This will tend to reduce authorities' resources. The Office of the Deputy Prime Minister calculates that the changes proposed here would increase the rebasing amount from around 2% to around 4% of the national total of management and maintenance allowances.

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This means that while the impact on local authority housing revenue accounts at a national level would be neutral, the impact on individual accounts may be significant. Authorities will lose different amounts of resources through the proposed increases in rent. Authorities will also gain different amounts of resources through the changes in rebasing, in particular authorities that have management and maintenance targets that are significantly below their current allowances – including all the London Boroughs – would be unlikely to gain significantly from the rebasing of the allowances. The exact impact on different authorities could only be established following a detailed analysis of their position with regard to rents and housing subsidy. However, this may lead to a further redistribution of resources away from London.

Property Valuations

There is no proposal to update the effective year of property valuation from 1999. When the rent restructuring formula was designed, it was decided to use 1999 as the valuation year because it was argued that the significant increases in property values following 1999 that particularly affected London were aberrational. Since 2001 these trends have continued and the gap between property values in London and other parts of England has increased further. An updating of the valuation year used would therefore have increased relative rents in London and reduced them in areas where increases in market values have been more modest. This may have helped authorities and housing associations that are grappling with the problems of letting properties in areas of low value and low demand. However, continuing with 1999 as the base year will prevent even greater increases in rents being made in some of the higher value areas.

However, the review steering group has concluded that the existing rent restructuring policy has resulted in a reduction in social rents in London when compared with private sector rents. The average housing association rent on a new letting was 47% of the average private sector rent in 1999 but only 40% in 2002. The average council rent in London was 44% of the average private sector rent in 1999 but only 38% in 2002.

Since housing associations and local authorities have valued their properties for rent restructuring it has emerged that average local authority valuations are 4% higher than anticipated by the government while housing association valuations are 13% higher. This leaves average housing association values 20% higher than average values for local authorities, being a greater gap than had been anticipated.

If the government presses ahead with its reforms of housing benefit to introduce the local housing allowance – being a flat rate direct payment to tenants that is designed to provide a 'shopping incentives' – this disparity in housing association and local authority rents could see a movement of tenants away from housing associations and towards local authorities. The rent restructuring process was designed to prevent this from happening.

This has prompted the government to ask the Housing Corporation to inspect the property valuations of the housing associations that have the highest rents. Evidence suggests that some housing associations have completed their statistical returns incorrectly, while others genuinely have more valuable stock.

It is understood that some housing associations have used the National Housing Federation estimation model and building society house price data to arrive at their valuations rather than paying for a formal valuation assessment.

The Corporation intends to carry this out as part of its normal regulatory activity, and one of their spokesmen said:

"There are no plans to review valuations though we would expect to investigate those organisations with anomalous rent levels as part of our regulatory role. Rent rises have actually slowed since 1997."

Service Charges

The review steering group found that most housing associations have introduced service charges whereas most local authorities have not, and concluded that:

"Further progress by local authorities in separating out service charges will be needed to achieve harmonisation with housing associations."

The Government's View

The government considers that rent restructuring has 'passed its three-year health check'. They consider that the restructuring of social rents in England has ensured a fairer and more coherent system.

Housing Minister Keith Hill said social tenants were clearly benefiting from rents that were well below what the private sector would charge for similar properties:

"The Government is committed to ensuring social housing remains affordable for people on low incomes. Tenants will continue to be protected from large or sudden rent increases.

"To make sure our policy is on track we used a three-year review to gather evidence, data and intelligence on the effects of the rent restructuring policy. The proposed changes will ensure a fairer pattern of rent differentials between properties of different sizes, and simplify the policy by adopting a common formula for all councils and housing association properties."

Response of the National Housing Federation

The main concern of the National Housing Federation is that the recommendations of the review steering group do nothing to help housing associations to achieve the decent homes standard or to increase the supply of affordable housing.

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Danny Friedman, Director of Policy at the National Housing Federation, said:

"From the inception of the rent restructuring proposals, the Federation argued that incentives to develop new larger homes – particularly to meet the needs of Black and Minority Ethnic communities – were missing, and that the formula unhealthily compressed the rents of different sizes of homes. We are therefore pleased that we have won our argument, and that rents will be able to more realistically reflect the size of home.

"An opportunity to make progress towards meeting the Decent Homes Target and increasing housing supply is in danger of being missed if the recommendation to retain the retail price index plus 0.5% increase framework is accepted by government.

"Building and repair costs rose by 18% in 2002/2003, consistently outstripping the rent increase envelope. The Federation has argued that a framework of retail price index plus 1% would only add an extra thirty pence to a tenant's average weekly rent, but the extra revenue generated could lever in additional private finance to build an extra 10,000 homes.

"The negative impact of continuing the retail price index plus 0.5% regime, such as cuts to development programmes and concern about long-term maintenance and stock condition is acknowledged in the evidence of the report, but not reflected in the conclusions and recommendations."

Response of the Local Government Association

The Local Government Association has opposed the proposal to harmonise council housing and housing association rents through using average values for social housing for both sectors. Their housing executive met shortly after the publication of the consultation paper and agreed to voice their concerns about the proposals and to launch a 'road testing' of the proposals.

They agreed to carry out a 'rigorous assessment' in the 'real world' using data from thirty authorities that would 'really test the assumptions and impacts'.

The Office of the Deputy Prime Minister has conceded that their proposals would cause 'slightly higher rent increases' in local authorities, but denies reports that increases of up to 20% could occur before 2011/2012.

The Office of the Deputy Prime Minister calculates that in 2005/2006 council rents will increase on average by 40p, with an average increase of £2.60 by 2012.

The Local Government Association has also complained that, while housing associations will see the financial benefit from greater than anticipated rent increases, local authorities will not as increased rents would be reflected in reduced housing subsidy.

David Thompson, Programme Manager at the Local Government Association said:

"The review was never designed for complete harmonisation. We therefore question why with 'small differences' any changes should be made.

"We are saying that we should stick to the current formula which will result in harmonisation and leave only a small difference."

It is unclear how the government intends to consult with tenants on this matter as no specific consultation exercise with tenants is proposed.

Conclusions

Anyone who hoped for radical change in rent restructuring as a result of this review would be disappointed, but should not be surprised as the government has always made clear that this review would look at operational rather than policy matters.

The review has even shied away from the issue of updating the base year for valuations – something that may have helped authorities and housing associations that are grappling with the problems of letting properties in areas of low value and low demand. However, continuing with 1999 as the base year will prevent even greater increases in rents being made in some of the higher value areas.

Harmonising the formula will facilitate 'convergence' of rents between the two sectors, and will lead to higher rent increases than would otherwise be the case in the local authority sector. Increasing the bedroom weighting for larger homes will increase rents for those homes and the income of housing associations, and will lead to greater differentiation between rents for larger and smaller homes. Removing the lower limit for rent increases will reduce rents for affected homes. Local authorities will continue to be encouraged to separate out service charges.

The proposals will have an impact on the budgets of local authorities. Even if the fears of the Local Government Association are not realised, there will be a redistribution of resources. While it is difficult to calculate exactly what the impact may be on different authorities this may lead to a further redistribution of resources away from London.

Housing Associations are disappointed that the opportunity has not been taken to raise average rents more rapidly thus providing resources for additional affordable housing, the need for which was identified as part of the Barker review. Some housing associations may be even more disappointed if the Housing Corporation concludes that their rents should actually be reduced following review of their methodology.

Local authorities and housing associations would be wise to calculate the likely effect on their budgets of these proposals, to identify any potential problems, and to refer to these as part of any submissions that they will make as part of the consultation exercise.

Adrian Waite – August 2004.

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