Wokingham Borough Council
Rent Setting Options for April 2015

Introduction

The national guidance which lays out the basis for local authorities to set their rents has changed. Following on from the consultation that was published in June 2013 and then finalised (without material amendment) in May 2014.

In essence this policy has a significant impact on how rents will be set for the next ten years commencing in April 2015.

This briefing sets out both how rents have been set in the past, how the new policy changes this and the potential options which could be open to the Council.

Past Rent Policy

The outgoing policy of local authority rent setting was commonly known as 'rent restructuring'. It was introduced in 2001 and sought to equalise – subject to some tolerances - all social rents (local authority and housing associations) over a 10 year period.

Rent restructuring worked by setting a formula rent for each property and then moving the actual rent to the formula rent over time. Formula rent has increased by RPI + 0.5% each year (apart from 2001-02 where it was uplifted by RPI + 1%) and actual rents have been allowed to increase by up to RPI + 0.5% plus an element for convergence where actual rent is below formula rent. In order to prevent excessive year on year rent increases, the amount of increase related to convergence has been capped at £2 per week. The trajectory of rents from the starting point to the formula rent is known as the target or guideline rent.

The formula rent was calculated with reference to a number of factors relating to the property and the local economy. The formula rent is calculated as follows:

70% x (bedroom factor x national average rent x relative earnings)
plus 30% x (national average rent x relative property value)

We have updated the rent model to exclude properties sold under right to buy, shared ownership and Eustace Crescent.

With a revised property basis of 2,629 the average actual rent is £107.49 against an average formula rent of £112.80.

Therefore there is a significant gap of £5.31 between the average actual and formula rent. With 342 tenancies currently at formula rent this difference can be attributed to 2,287 and is broken down in the following bands:

Under £5 – 1,459
Between £5 and £10 – 275
Between £10 and £15 – 339
Over £20 – 214

Given that these differences would have been made up utilising the £2 cap above formula it would have taken well over 20 years for some properties to converge unless they were re-let to new tenancies.

Using an RPI of 2.3% for April 2015 and then 2.5% thereafter the average rent increases would have been as follows for the next 10 years. This demonstrates that nearly 10% of the stock would still not have converged but more worryingly that 41 properties would have a differential of more than £20.

Table of Rent Increases Under the Previous Rent Restructuring Regime

		2014.15	2015.16	2016.17	2017.18	2018.19	2019.20	2020.21	2021.22	2022.23	2023.24	2024.25
Average Rent - Tenanted		£107.49	£111.48	£115.57	£119.69	£123.85	£128.07	£132.35	£136.69	£141.10	£145.61	£150.19
Average Increase - Overall			3.72%	3.67%	3.56%	3.48%	3.41%	3.34%	3.28%	3.23%	3.19%	3.15%
Average Increase - Tenanted			3.72%	3.67%	3.56%	3.48%	3.41%	3.34%	3.28%	3.23%	3.19%	3.15%
Maximum Increase - Tenanted			6.06%	6.08%	5.91%	5.74%	5.59%	5.45%	5.33%	5.21%	5.11%	5.00%
Average Formula - Tenanted		£112.80	£115.96	£119.43	£123.02	£126.71	£130.51	£134.42	£138.45	£142.61	£146.89	£151.29
Tenants Converged		342	1,515	1,724	1,821	1,925	2,015	2,106	2,173	2,245	2,310	2,369
Tenants Not Converged		2,287	1,114	905	808	704	614	523	456	384	319	260
% Tenanted Converged		13.0%	57.6%	65.6%	69.3%	73.2%	76.6%	80.1%	82.7%	85.4%	87.9%	90.1%
Average Gap			£10.55	£11.21	£10.84	£10.68	£10.42	£10.43	£10.20	£10.30	£10.54	£11.15
Number of Tenants over	£5.00	275	254	243	190	206	158	127	70	79	84	72
	£10.00	339	306	278	240	163	144	128	138	112	94	79
	£20.00	214	177	147	121	108	101	95	61	47	42	41

<u>The New Social Rent Policy</u>

Following on from the September 2013 consultation the 10 year new social policy has been confirmed. It can easily be summarised as follows:

- The RPI +0.5% increase to formula rents will be replaced by CPI +1%, as CPI is being used as a replacement for RPI in the majority of inflationary increases used by the Government
- There will be no further continuation of rent convergence - so in other words April 2014 rent levels will only increase by CPI +1%
- An expectation that new tenancies will be let at formula rent rather than the outgoing rent level
- Rent Rebate Subsidy Limitation will remain (until any replacement following the introduction of Universal Credit)
- Where a tenant’s household earnings are in excess of £60,000 the ability to charge market rent levels
- Current Rent Caps will remain- increasing by CPI +1.5%

Much representation was made by Council’s over the removal of rent convergence, as the savings had been factored in the 2015 Spending Review it was seen as impossible to reverse the guidance and that Council’s (and some Housing Providers) would have to find savings in which to balance their business plans.

The move to CPI plus 1% instead of RPI plus 0.5% will see an impact to the rental income stream to the Council even before the loss of convergence. The reason for this is that the recently published inflation statistics for September 2014 are a CPI of 1.2% and RPI of 2.3%. Therefore if the Council follows the latest guidance then rents are set to increase by 2.2% whilst increases would have been 2.8% to existing rents before the convergence factor. We estimate this to be in the order of £88,000 before voids and right to buy sales.

In overall terms the loss of convergence and the movement to CPI plus 1% has resulted in a comparable loss of £223,000 before voids and right to buy sales. When assessing this over a longer period of ten years this increases to a total of £6.189million of comparable lost revenue to the HRA business plan. This figure assumes a CPI of 1.2% for 2015.16 and then 2% thereafter.

What are the Potential Options?

The move to the new social rent policy, i.e. no rental convergence and using CPI plus 1% instead of RPI plus 0.5%, represents a real loss of potential income.

More importantly it maintains the scenario of existing tenancies being charged considerably less rent than incoming new tenants. Note the 214 properties of over £20 difference.

It should be noted that there is no statutory underpinning for rent setting. Local authorities are free to set any rent they see fit as long as it meets the provisions of the 1985 Housing Act. Section 24 of the 1985 Act states the following:

24 (1) A local housing authority may make such reasonable charges as they may determine for the tenancy or occupation of their houses

24 (2) The Authority shall from time to time review rents and make such changes, either of rents generally or particular rents, as circumstances may require

That is all. The 1989 Local Government and Housing Act added clauses 24 (3) and 24 (4) which stated that in exercising their functions under this section, a local housing authority shall have regard in particular to the principle that the rents of houses of any class or description should bear broadly the same proportion to private sector rents of houses of any other class or description. However, this was repealed in England (it is still extant in Wales) by the Local Government Act 2003. Therefore, local authorities have no restriction other than reasonableness when deciding on the basis to set rents.

In the past external factors such as the Housing Subsidy system almost dictated rent increases given that increases in the sums payable to the Government meant that rents had to be put up accordingly.

Also with the introduction of Self-Financing in March 2012 the settlement which resulted in £95.468million being taken on by the Council was calculated on the basis of rent convergence, albeit with adjustments recognising the impact of the £2 above inflation increases. Therefore rents were increased to meet interest and debt repayment requirements.

For the two reasons above the Council has followed the outgoing policy of rent convergence.

With the new policy commencing April 2015, it now seems appropriate to look again at how rents are set. As described above, the Council has considerable scope to determine the level of rent.

Under Self-Financing, rental income needs to service the business plan's debt financing, service and investment needs. However, the method by which rents are set at an individual property level is down to the council. There are a number of principles that any rent setting policy should adhere to:-

- Simple and easy to understand for tenants
- Fair and equitable between tenants
- Reflective of the quality of the product received
- Meet legislative requirements

There are a number of ways in which this can be approached with four main options for setting rent. Under these options there are many variations.

- Continuation of the current formula based rent linked to property value and earnings – this could be updated to reflect current property and earnings values. A variation on this could be to reduce the formula rent overall and freeze rent for those close or at convergence and then have larger than CPI plus 1% increases for those further away from formula rent but maintaining an overall rent increase in the region of 2.2% (or higher) as a way of ensuring fairness
- A points based system whereby certain dwelling characteristics added to the rent of the property. These could include number of bedrooms; garden; energy efficiency; location; quality (however measured) etc…
- Set in relation to market rents for an area, e.g. x % of market rent with a minimum and maximum threshold
- Set in relation to people's ability to pay. This could be used in conjunction with any of the above so that where households can afford a higher rent this is charged. This is set out in the Government's pay to stay proposals.

Further work would be needed to understand what data is available to support these options and how they would impact on the business plan.

Any new system would need time to be introduced and would have to be done so in a measured way as to avoid large year on year movements. However, with the changes to the national system now seems the appropriate time to consider this issue to bring fairness across the portfolio of properties so that rents better reflect the property being occupied.

Possible Implications

Rent Rebate Subsidy Limitation still applies though may not appear such a threat. Currently the limit rent is set at £114.39 and will increase by 2.2% to £116.90. This is some way from your projected average rent of £109.85 if a 2.2% uplift is applied. Therefore it would take significant rent increases, and certainly over the £115.28 projected average formula rent.

If the average actual rent were to increase over the limit rent then a proportion (based on the amount covered by Housing Benefit) would be repayable to the Government thus negating some of the benefit of higher levels of rent.

The introduction of Universal Credit, particularly when the Housing Element is applied, may cause some issues as rents will have to be deemed ‘reasonable’. Current guidance states that affordable rents levels will be considered ‘reasonable’.

Suggested Proposal

In recent years there were significant variances between the actual rents and target rents for the majority of shared ownership properties. This was remedied by having greater increases to these shared ownership rents over a four year period.

A similar approach could be made for the current tenanted rented properties that are significantly below the rent levels they should be at.

A scenario could be as follows with convergence with target rent by 2018.19 (4 years):

- If your rent is less than £5 below target then increases are limited to CPI plus 1% plus £0.50
- If your rent is more than £5 but less than £10 below target then increases are limited to CPI plus 1% plus £2.00
- If your rent is more than £10 but less than £20 below target then increases are limited to CPI plus 1% plus £5.00
- If your rent is more than £20 below target then increases are limited to CPI plus 1% plus £10.00

The resulting table is as follows:

	2014.15	2015.16	2016.17	2017.18	2018.19	2019.20	2020.21	2021.22	2022.23	2023.24	2024.25
Average Rent - Tenanted	£107.49	£111.15	£115.82	£120.66	£125.68	£129.45	£133.34	£137.34	£141.46	£145.70	£150.07
Average Increase - Tenanted		3.41%	4.20%	4.18%	4.16%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Maximum Increase - Tenanted		14.81%	14.31%	13.19%	12.18%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Average Formula - Tenanted	£112.80	£115.28	£118.74	£122.30	£125.97	£129.75	£133.64	£137.65	£141.78	£146.03	£150.41
Tenants Converged	342	342	342	344	2,052	2,052	2,052	2,052	2,052	2,052	2,052
Tenants Not Converged	2,287	2,287	2,287	2,285	577	577	577	577	577	577	577
% Tenanted Converged	13.0%	13.0%	13.0%	13.1%	78.1%	78.1%	78.1%	78.1%	78.1%	78.1%	78.1%
Average Gap		£4.74	£3.35	£1.88	£1.29	£1.33	£1.37	£1.41	£1.46	£1.50	£1.55

Number of Tenants over	£5.00	275	327	445	208	4	4	6	6	6	3	3
	£10.00	339	322	209	20	1	1	1	0	0	3	3
	£20.00	214	104	14	1	0	0	0	1	1	1	1

Over this period this scenario would bring in an additional £7.02 million in rental income before voids and right to buy sales based on the same inflation assumptions as above.

Only one property would remain above £20 of formula rent and the vast majority of properties with rents within £2 of formula rent.

In this scenario those properties that are actually over formula rent have been brought back in line over a 4 year period, so would have less than CPI plus 1% increases to ensure a greater degree of fairness.

A further proposal would be:

- If your rent is less than £5 below target then increases are limited to CPI plus 1% plus £1.50
- If your rent is more than £5 but less than £10 below target then increases are limited to CPI plus 1% plus £3.00
- If your rent is more than £10 but less than £20 below target then increases are limited to CPI plus 1% plus £6.00
- If your rent is more than £20 below target then increases are limited to CPI plus 1% plus £15.50

The resulting table is as follows:

		2014.15	2015.16	2016.17	2017.18	2018.19	2019.20	2020.21	2021.22	2022.23	2023.24	2024.25
Average Rent - Tenanted		£107.49	£111.21	£115.94	£120.86	£125.97	£129.75	£133.64	£137.65	£141.78	£146.03	£150.41
Average Increase - Tenanted			3.46%	4.26%	4.24%	4.23%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Maximum Increase - Tenanted			15.28%	14.69%	13.49%	12.52%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Average Formula - Tenanted		£112.80	£115.28	£118.74	£122.30	£125.97	£129.75	£133.64	£137.65	£141.78	£146.03	£150.41
Tenants Converged		342	342	342	344	2,629	2,629	2,629	2,629	2,629	2,629	2,629
Tenants Not Converged		2,287	2,287	2,287	2,285	0	0	0	0	0	0	0
% Tenanted Converged		13.0%	13.0%	13.0%	13.1%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Average Gap			£4.68	£3.21	£1.66	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00	£0.00
Number of Tenants over	£5.00	275	327	387	208	0	0	0	0	0	0	0
	£10.00	339	322	209	21	0	0	0	0	0	0	0
	£20.00	214	104	14	0	0	0	0	0	0	0	0

Over this period this scenario would bring in an additional £7.37 million (from the base assumption) in rental income before voids and right to buy sales based on the same inflation assumptions as above.

All properties would have converged, including those over formula rent by April 2018.

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October 2014