Levelling rents

Rebalancing submarket rents to make renting fair

Network Homes

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Foreword

As social landlords, the rents we charge are fundamental to our common core purpose of meeting housing need.

Our below-market rents are what makes us social landlords, arguably more so than the surplus we reinvest into new/existing homes. They are important to tenants, because they pay less than they would renting from a private landlord. For tenants who pay themselves, this leaves more money for them to spend on other things, and for tenants whose rent is paid by the welfare system, this creates less of a poverty trap than paying market rates.

Our rents are also important to us. They provide the overwhelming majority of our income – income which we need in order to provide landlord services while investing in the safety of our buildings and developing new homes for the 250,000 households in London and well over 1,000,000 in England waiting for an affordable and secure place to live.

Clearly there is a tension between these two functions of submarket rents. The introduction of higher Affordable Rents in 2011, coupled with much lower rates of grant, sought to maintain this balance by letting Housing Benefit take the strain. But in doing so, we are now in a difficult situation where tenants living in similar homes of similar sizes pay radically different amounts.

And adding to the unfairness, those on higher rents are more likely to be in higher need, as on average they moved into social housing more recently, when housing lists were longer and so the threshold of need was higher.

The problem of rents has been parked in the too difficult box for many years, with different government policy pulling in different directions, including the most recent proposal to cap rent increases in 2023. It is time we started to talk about how to get it out of that situation. We need to get into a place where we can confidently say to tenants that the system is fair and equitable for all, regardless of which Affordable Housing Programme produced their home.

A policy of levelling rents – returning to rent convergence in order to fund the conversion of Affordable Rents to Social Rents – would reduce the number of high rents, helping tenants with the cost of living, and helping them out of a poverty trap. It would also reduce the unfairness of wildly disparate rents which don't reflect size, location or quality.

At Network Homes, such changes would allow us to bring more than 650 of our 2,000 Affordable Rents down to Social Rent levels over ten years. Across the sector as a whole, this would bring back fairness to the system and help those most in need.

Helen Evans
Chief Executive

Executive summary

A series of policy changes over the last decade have led to a social housing rents system that has three major problems.

It is extremely complicated, making it difficult to explain to residents and costly to administrate. It is unfair, in the sense that properties of the same size and quality, in the same location, are sometimes charged different rents. And it involves rents that are often extremely high by traditional standards, i.e. Affordable Rents.

High Affordable Rents reduce work incentives and living standards. Several welfare reforms have attempted to reintroduce work incentives by restricting access to benefits, such as the household benefit cap. But the cap also causes extreme hardship in some cases, and negatively impacts the development of larger homes. Keeping social housing rents low in the first place avoids all of these problems.

Given the complexity of the system, introducing a new rent model is not a sensible option. But changing regulation to allow for rent levelling – social landlords raising very low rents and using the proceeds to lower very high rents – would solve several problems at minimal cost. It would banish extremely high rents, reinstating work incentives and removing the need for a benefit cap. It would also reduce the unfairness of wildly disparate rent levels that do not track size, quality or location.

At Network Homes, simply raising rents which are below their target levels up to target would allow us to reduce hundreds of Affordable Rents down to target rent levels. Raising all Social Rents so that they are on average £2/week (£104/year) above their target levels would allow us to lower all our Affordable Rents to an equivalent level.

This rent levelling is not a straightforward solution. It would require a change in rent regulation and would involve additional costs to many existing households in social housing. But given the unfairness of the current system, we believe it must be considered.

Recent rent policy

In 2000, the Labour government wrote that the lack of a unified approach with councils and housing associations had over several years led to a rent system which was 'arbitrary', 'unfair', and 'extremely confusing'.[1]

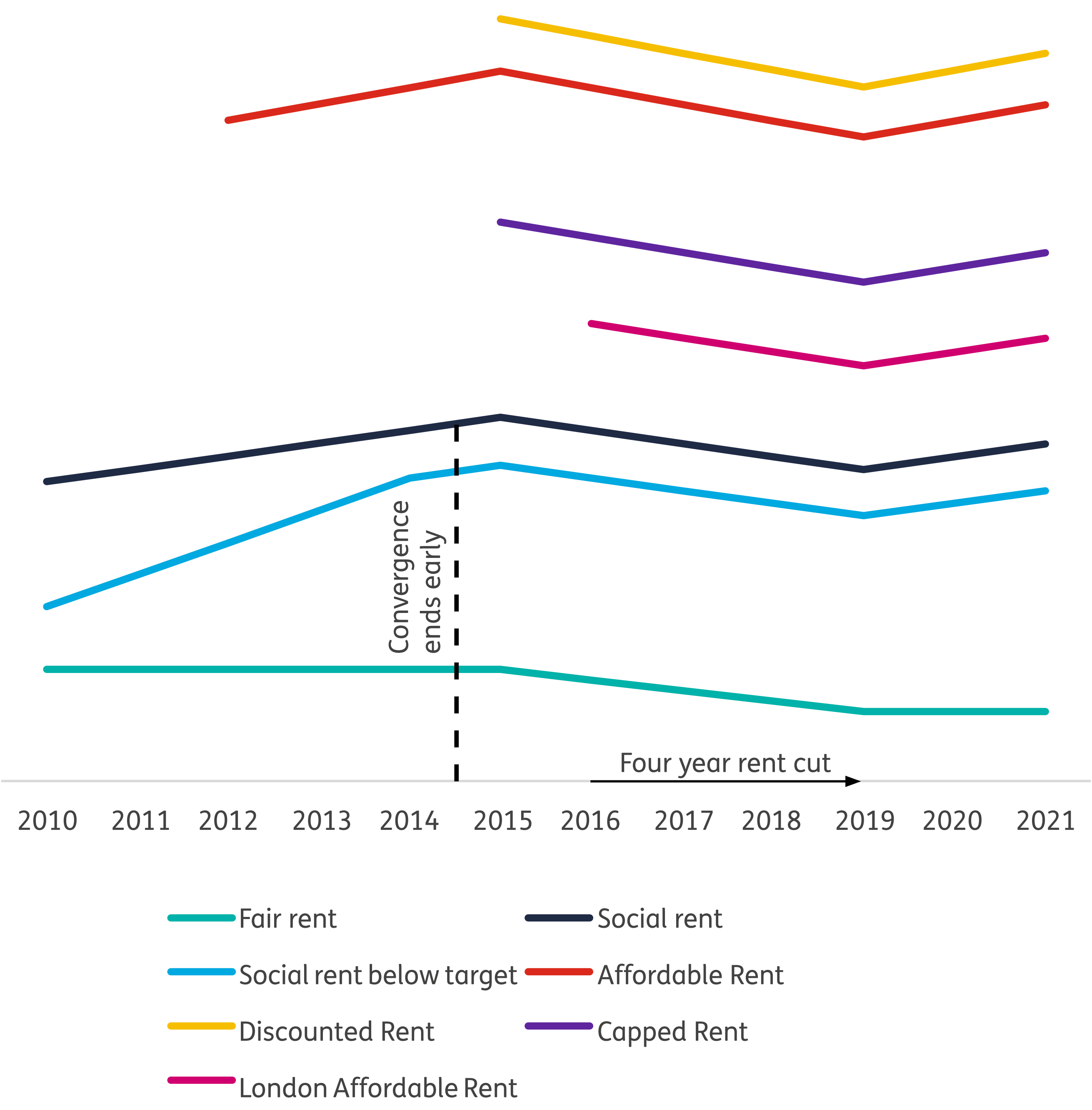
The solution was to gradually converge rents to levels set by a standardised, but very complex, Social Rent formula, which took into account average manual earnings at county level, number of bedrooms, and property value in 1999. Rents determined by the formula are known as 'Social Rents', 'formula rents', or 'target rents'.

In 2010 the coalition government withdrew funding for new Social Rented homes and introduced a more expensive social housing rent model, Affordable Rents, to be set at up to 80% of market rents (Social Rents being roughly 50% of market rents at the time).[2] Capital grant funding for housebuilding was drastically reduced, from an average of £60,000 per new home in the 2008-11 programme, to £20,000 in 2011-15, and then to £17,400 in 2015-18.[3]

In London, market rents were so high that the Greater London Authority (GLA) required landlords to achieve an average Affordable Rent of 65% of the market. Under Boris Johnson's Housing Covenant 2015-18 programme, landlords were required to set half of their Affordable Rents at 50% of market rents – Capped Rents – and half at 80% – Discounted Rents.[4]

While the introduction of Affordable Rent encouraged social landlords to set higher rents than they had done traditionally, two other policy changes sought to avoid high rents. The first was the decision to end the convergence programme a year early (2014/15), which unexpectedly left social landlords unable to increase rents towards their target levels during tenancies. The second was the requirement that social landlords reduce rents by 1% annually 2016/17-2019/20, resulting in a 12% reduction in average rents by 2020-21 compared to what they would have been otherwise.[5]

Figure 1: Different rent regimes since 2010



Recent rent policy

In London, Mayor Sadiq Khan's Affordable Homes Programme 2016-21 introduced two new rent models: London Affordable Rent, effectively a slightly higher formula rent re-packaged as Affordable Rent, and London Living Rent, a rent-to-buy product with sub-market rents allowing tenants to save for a deposit to buy a share in their home within 10 years. London Living Rents are set at a third of median household incomes at borough level, varied at ward level for house prices, and adjusted by bed-count.

Meanwhile, social housing residents with 'regulated tenancies' from before 1989 were still eligible for fair rents. These rents, determined by the Valuation Office Agency, are set without regard to housing scarcity and other factors which affect a market valuation.

The new rent models and policy changes are summarised in figure 1. The arrows indicate whether the model was low or high by traditional standards, or whether the policy raised or lowered rents. It is fair to say that the problems the Labour government identified in 2000 – especially that the system is 'extremely confusing' – have only worsened.

The complexity of the current system increases administrative costs around rent setting and raises the risk of residents being charged incorrect rents.[6] It also reduces transparency and trust. 83% of Network Homes residents we surveyed said it was important to them to understand why their rent is set as it is, but in the current system, it is very hard to explain in a clear and accessible way why rents are set as they are.

The proliferation of rent models also leads to unfair situations in which properties of the same size and condition, in the same location, are charged different rents, purely because different rent policies were attached to their grant funding. We know this is an issue at Network Homes, with one resident telling us: "Most neighbours in the same block with bigger flats pay half of what my rent is due to the old agreement they have. It's very unfair."

Alongside changes in rent policy, coalition and Conservative governments were implementing major welfare reforms. Many reforms restricted claimants' benefits entitlements, such as the household benefit cap, the benefits freeze, the bedroom tax, benefits sanctions, the two-child limit, and the five-week wait for Universal Credit (UC). The IFS finds that the average benefit entitlement among unemployed households in 2020–21 is 10% lower than it would have been without any policy changes since 2011.[7] At the same time, housing associations' financial models were coming under increasing pressure, with the result that it became more difficult to let new homes at Social Rents.[8]

Affordable Rent and the household benefit cap

Affordable Rents are generally much higher than Social Rents. But the question of why high rents are a bad thing in social housing is less straightforward than it appears.

We need to distinguish between three kinds of households, those who receive Universal Credit and Housing Benefit (HB) and those who don't:

Households whose rent is fully covered by UC or HB

For these households, rent level makes no difference to income after housing costs. The problem with high rents is not unaffordability, but reduced work incentives. Simply put, it is harder for these residents to improve their living standards through work, since more of their earnings are swallowed up by their housing costs.

Households whose rent is partly covered by UC or HB

Here the problem with high rent depends on the amount of rent not covered by HB or UC. If HB or UC cover all but £10 of the rent, for example, then high rents do not present a problem for income after housing costs – paying rent reduces income after housing costs only by £10, no matter how high the rent. In such a case the problem with high rent is, again, reduced work incentives. At the other end of the spectrum, if HB or UC only cover £10 of the rent, then a high rent will reduce income after housing costs by a high amount (the rent minus £10).

Households not in receipt of UC or HB

This is the simplest case, where high rents simply mean high deductions from income, which may leave households struggling to afford non-housing essentials.

The problem with high rents can therefore be reduced work incentives or reduced living standards (through reduced income after housing costs), depending on the situation. Since almost two thirds of social housing households receive HB or UC,[9] and at least half of those who receive HB have their rent fully covered,[10] we know that high rents present a threat to work incentives for many social housing residents.

One welfare policy designed to address the problem of low work incentives is the household benefit cap. Under this policy, if the entitlements of a household reliant on certain benefits exceed the cap, the excess is deducted from their Housing Benefit award, or the housing element of their Universal Credit award. Annual caps in London are £15,410 (single adult) and £23,000 (couples and families) and, outside of London, £13,400 (single adult) and £20,000 (couples and families).

The cap has affected 400,000 households since its introduction, with the latest figures showing that 150,000 households currently have their benefits capped. The number of capped households almost doubled between February and May 2020, driven by the extreme increase in households claiming UC due to the pandemic.[11]

The cap counteracts the reduction of work incentives brought about by high rents. Single adults can avoid the cap if they work 30 hours a week, while pensioners and families can avoid it if they work 16 hours a week.[12] But the policy has at least two major problems.

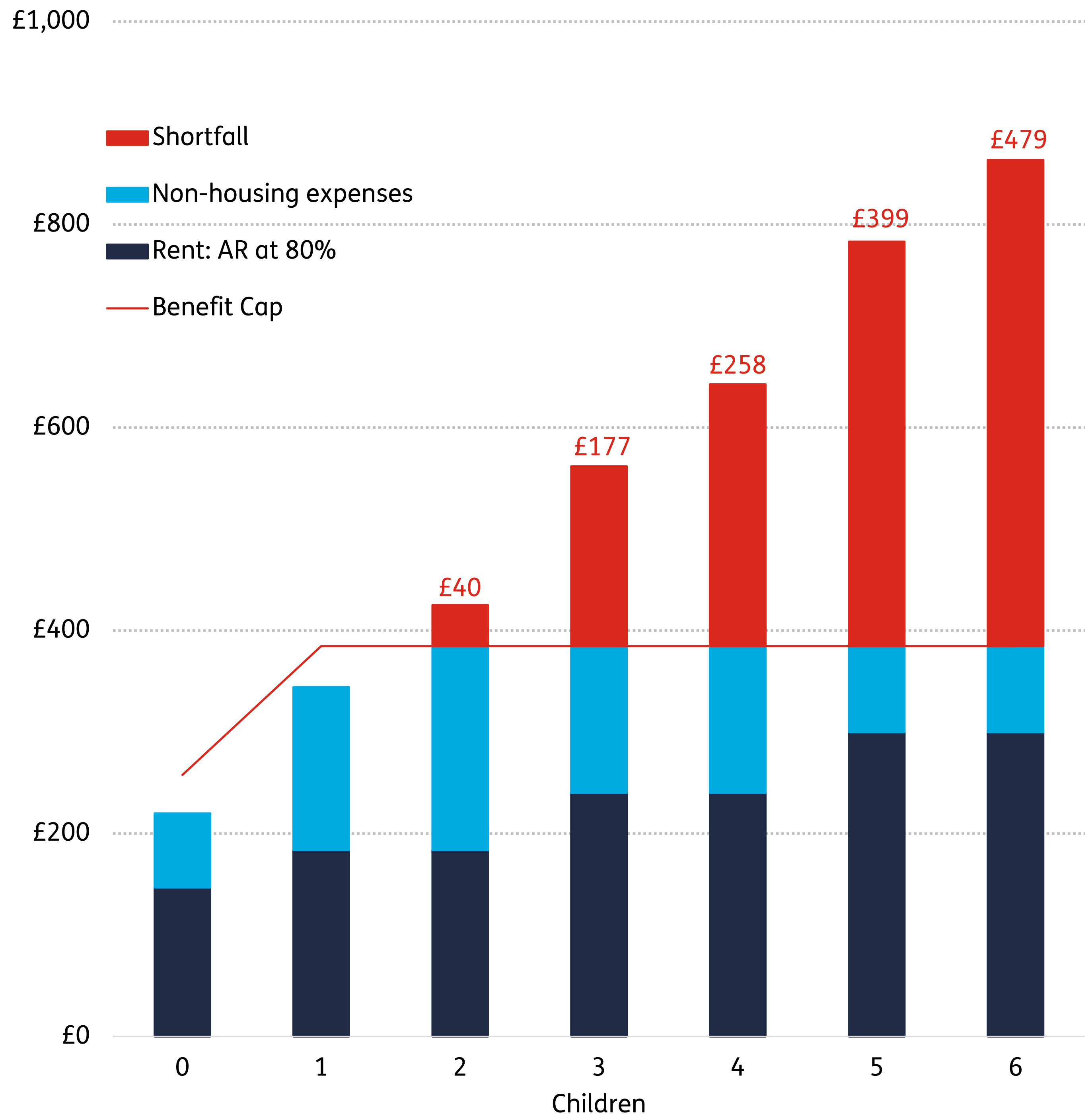
1 The benefit cap causes severe hardship

A capped household is indeed incentivised to find work – but many households face barriers to doing so, and more are likely to find it harder in the emerging coronavirus jobs crisis. Households who do not enter work face extreme shortfalls in their benefits entitlements, requiring them to cut back on essentials like food and heating if they are to pay their rent.

Figure 2 indicates just how severe these shortfalls can be. It shows the situation for unemployed single parents in East Hertfordshire charged Affordable Rents at 80% of market rent. The blue bars represent the household's non-housing entitlements, which serve as a proxy for essential non-housing expenditure.[13] The numbers above the bars show how far the capped entitlements fall short of the households' overall rent and essential non-housing expenditure. Single parents with more than three children receive over £1,000 per month less than they need for rent and non-housing essentials.

Affordable Rent and the household benefit cap

Figure 2: Monthly expenses and entitlements for single parents in Hertfordshire



2 The benefit cap also makes it more difficult to build larger homes

As indicated by figure 2, it is larger households who face the greatest shortfalls when capped, since larger households have higher living costs than smaller ones, but are capped at the same level. This means that if larger households facing the cap are to be able to pay rent, their rent must be very low. At Network Homes, we set many of our Affordable Rents for homes with more than two bedrooms using the Social Rent formula, for just this reason. In fact, our average Affordable Rent three-bed home is 4% cheaper than our average Affordable Rent two-bed home.

But larger homes are more expensive to build due to their size, and therefore require higher rents from a development finance perspective. The low rents necessitated by the benefit cap therefore make it financially difficult to build larger homes.

All of these problems – low living standards and work incentives, and the hardship and development issues caused by the benefit cap – could be avoided if rents were low in the first place. Low rents would not lower living standards or work incentives, and would remove the need for a household benefit cap, from a work-incentives perspective. Low rents would also therefore reduce hardship.

So we need to abolish the benefit cap, and we need to reduce high Affordable Rents.

Abolishing the cap would in fact have a minimal impact on government spending. In the first year of the reduced benefit cap, it is reported to have saved government £130m, which represents less than 1% of total welfare reform savings since 2010.

Rent levelling

If social landlords were permitted to roughly level their rents – raising the lowest and using the proceeds to lower the highest – they could avoid charging very high rents.

They could also reduce the unfairness of wildly disparate rent levels which do not track differences in size, quality, or location.

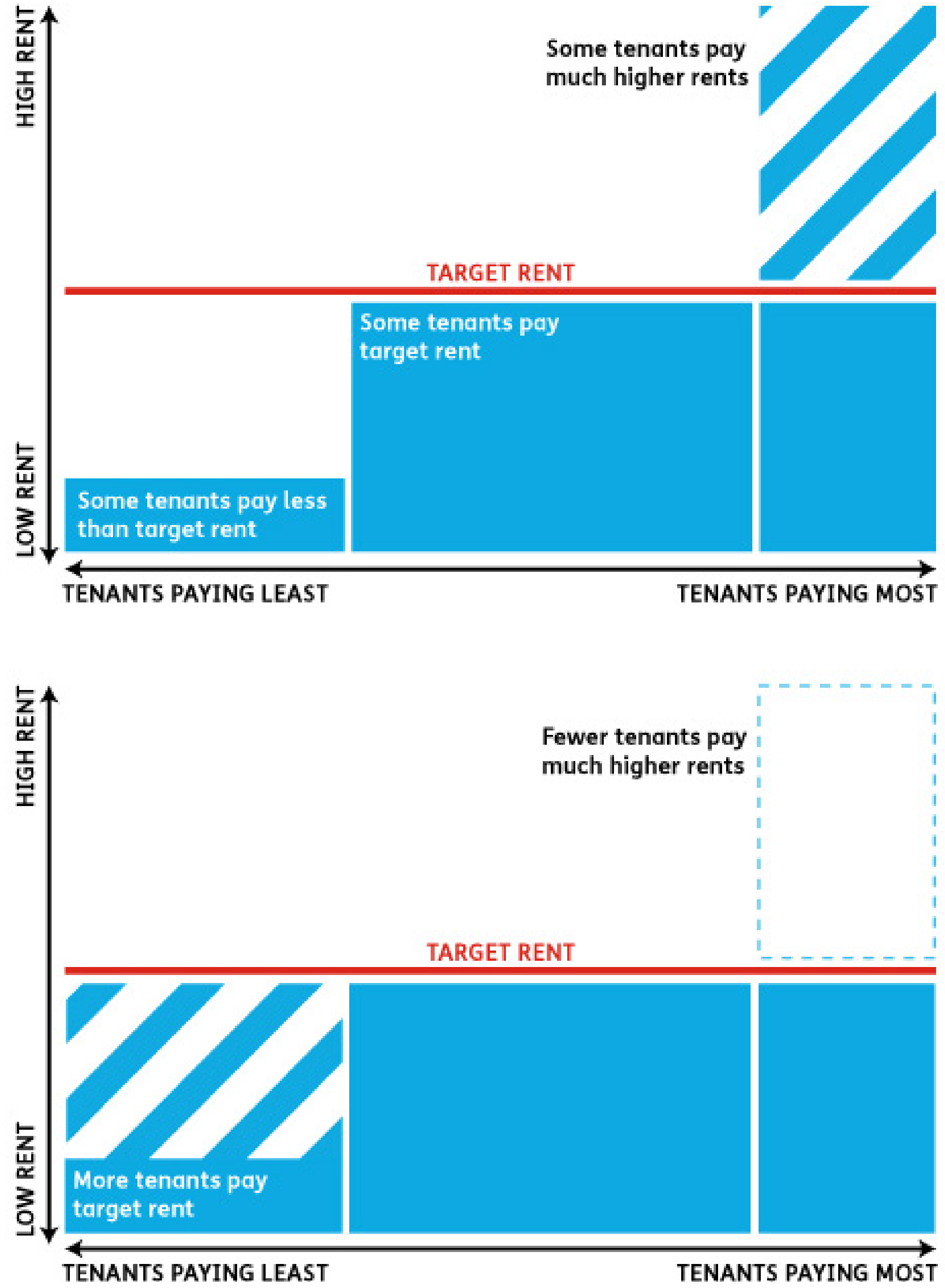
A rent levelling policy would require no extra grant funding from government, but it is impossible in the current regulatory regime.[14] So the policy would require changes to the Rent Standard of the Regulator of Social Housing and to related Department for Levelling Up, Housing and Communities (DLUHC), and possibly Homes England and Greater London Authority, policies.

Although there is an opportunity cost involved in spending the gains on reducing the most expensive rents, rather than on development or building safety, we consider improving work incentives and living standards for existing tenants to be a justified use of the gains, especially in the current economic climate.

There are several ways in which social landlords could implement such a policy, which can be represented as a spectrum. At one end, rent increases for those with the lowest rents are minimised. This is obviously advantageous for those with the lowest rents, but the disadvantage is that fewer Affordable Rents can be reduced. At the other end of the spectrum, the lowest rents are increased by however much is needed to lower all the social landlord's Affordable Rents. In other words, rather than minimising rent increases, we maximise rent decreases. Here the advantages and disadvantages are reversed: more people can be relieved of high rents, but with greater costs falling on those whose rents are currently the lowest.

Different social landlords will have different levels of disparity between their rents – for example, some may have several Social Rents below target levels and several Affordable Rents, others no sub-target Social Rents and few Affordable Rents. For this reason, it would make sense for each social landlord to find the point on this spectrum that allows them to balance their residents' interests.

Figure 3: Submarket rents before and after rent levelling



Minimising rent increases

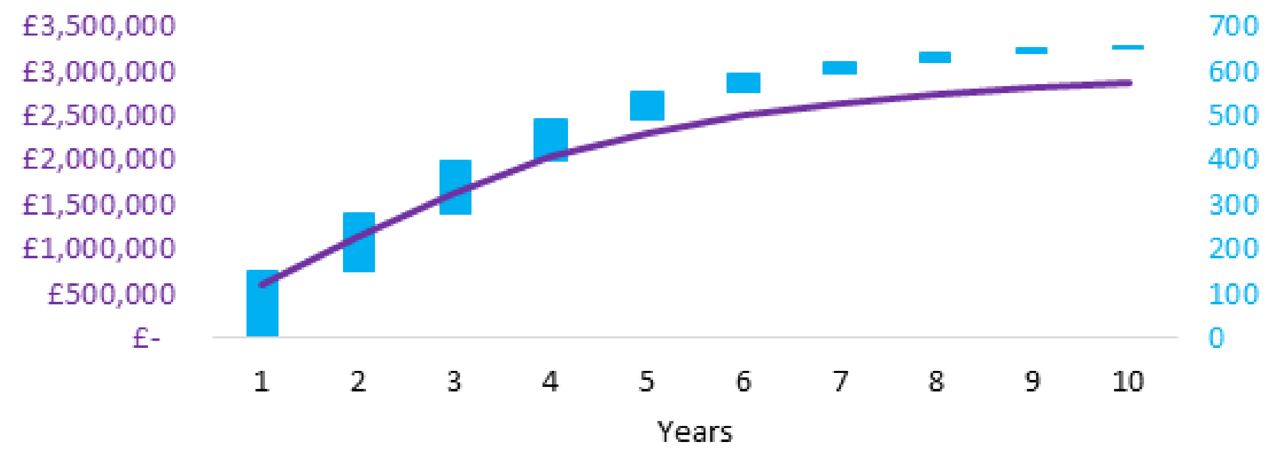
A sensible option at the increase-minimising end of the spectrum involves a return to rent convergence, with social rents below their target levels increased annually by £2/week (on top of the CPI+1% increase). The extra revenue would be used to convert Affordable Rents to social rents.

At Network Homes, over 6,000 of our social rents are below their target levels, on average by £11/week.[15] At the same time, our Affordable Rents are on average £65 higher than our average social rent (at target). We estimate that minimising rent increases reintroducing the £2/week provision would generate more than £21.3m in extra revenue over the next ten years (in real terms), which would allow us to convert 654 of our roughly 2,000 Affordable Rents to social rents.[16] The increase in revenue and conversions are visualised in figure 4.

This version of a rent levelling policy is built around social rent – but we should recognise that the social rent formula is illogical in many ways. The earnings and national average rent figures, as well as the property values, are all from twenty years ago. Earnings are specified at a county level, masking a great deal of lower level variation. And it is arguable that property values are in any case irrelevant to setting rents for people priced out of the market and with a very limited choice of homes. However, given the complexity of the rent system, attempting to replace social rent with a new model would bring additional challenges. The formula would ideally be improved, though spelling out how to do so would unduly lengthen this paper.

Since target rents are widely considered affordable, it is arguable that any rent increase that does not take a rent over its target level is also affordable. But it should be noted that increases will accumulate over time, and there will be a compounding effect as the £2 adds to the percentage increase. An absolute cap on annual rent increases could therefore be considered.

Figure 4: Extra rental income (left) and conversions from Affordable Rent to Social Rent (right)



Maximising rent decreases

At the other end of the spectrum, the policy would see all rents – Affordable Rents, and Social Rents whether at or below target – brought to roughly the same level (still with variation for size, location and quality).

For many social landlords, this approach would require increasing Social Rents beyond their target levels. This is the case at Network Homes, where we estimate that raising all Social Rents by an average of £13, to an average of £140, would allow us to lower all Affordable Rents to the same average level within 10 years. This would bring sub-target rents to an average of £2 per week above their target levels.

Clearly this option would involve higher costs for residents whose rents are currently the lowest, and so could not be implemented without careful impact assessments.

But it would have the advantage of removing very high rents altogether, and would also have a larger impact on the fairness of the rents system by entirely removing variation in rents other than for differences in size, location and quality.

The problems that beset the social housing rent system 20 years ago, and which made the convergence project necessary, have returned. Addressing the problems requires policy-making on the same level of ambition as that project. Abolishing the benefit cap and introducing rent levelling could be major steps forward in undoing the damage of recent rent policy and establishing a system that works better for residents.[17]

References

1. Department for Environment, Transport, and Regions, April 2000, ‘Quality and Choice: A Decent Home for All’, sections 10.12-10.14.

2. DCLG, ‘English Housing Survey 2010/11’, p. 18.

3. Average grant per unit figures from the National Audit Office, reported in Wendy Wilson and Alex Bate, May 2015, ‘Affordable Rents (England)’.

4. Trowers and Hamlins, 2014, ‘Consortium Delivery Agreement in relation to the Mayor’s Housing Covenant 2015/18 Programme’. More precisely: Capped Rents are the lower of (a) 50% of market rents, or (b) formula rent; Discounted Rents are the lower of (a) 80% of market rents, or (b) Local Housing Allowance.

5. National Housing Federation, July 2015, ‘Summer Budget 2015 briefing’.

6. In 2019/20, almost 20% of large registered providers were contacted by the Regulator about rent-setting anomalies. Social Housing, 6 August 2020, ‘Rent and regulation: when registered providers get it wrong’.

7. IFS, June 2020, ‘Living standards, poverty and inequality in the UK: 2020’.

8. See Network Homes, January 2019, ‘Why aren’t housing associations building more social rented homes?’

9. 56% of social housing households receive full or partial HB, and a further 7% receive UC. Family Resources Survey 2018/19, table 3.5.

10. As shown by the fact that the median rent after benefit among Social Renters in receipt of HB was £0. English Housing Survey 2018/19, table FA3241.

11. DWP, August 2020, ‘Benefit cap: number of households capped to May 2020’.

12. Based on hours needed to quality for Working Tax Credit, which exempts a household from the cap.

13. Entitlements as calculated by EntitledTo. Non-housing entitlements are UC standard allowance and child element, council tax support, and child benefit.

14. The current Rent Standard allows conversion of Social Rented homes to Affordable Rent only when it is part of an agreement with Homes England or the Greater London Authority. The Greater London Authority will no longer agree additional conversion. In all other circumstances rents can only increase with the general provisions in the Rent Standard.

15. In our calculations we always apply the 5% upwards flexibility on target rents.

16. We model a sudden as opposed to gradual conversion of Affordable Rents to Social Rents, during tenancies rather than at re-let.

17. We would like to thank all Network Homes residents who contributed to a focus group and survey on the issues discussed in this paper.

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