

19 December 2013

## Response:

# Rents for Social Housing from 2015-16

## Consultation

### Summary of key points:

The consultation, published by The Department for Communities and Local Government, invites views on the proposed rent policy for social housing from 2015 onwards. The Federation has worked with housing associations to understand the impact of the proposed new rent settlement. In this response we:

- Welcome the certainty that an index-linked ten year rent settlement provides for housing associations.
- Raise significant concerns about the consequences and legal implications of removing the flexibility for housing associations to increase weekly rents by an additional £2 per week to achieve convergence with target rent.

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## **1. Introduction**

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The National Housing Federation is the voice of affordable housing in England. We believe everyone should have the home they need at a price they can afford. That's why we represent the work of housing associations and campaign for better housing.

Our members provide two and a half million homes for more than five million people, representing around 11% of the population. And each year they invest in a diverse range of neighbourhood projects that help create strong, vibrant communities.

As part of the 2013 Spending Round, the Chancellor of the Exchequer announced a new social housing rent settlement from 2015 onwards. In October 2013 the Department for Communities and Local Government (DCLG) published a consultation on 'Rents for Social Housing from 2015-16' and a draft 'Direction on the Rent Standard 2013', also for consultation.

The consultation invites views on the proposed rent policy for social housing from 2015 onwards. It sets out the changes to the current rent policy that Government is proposing, namely:

- Moving from annual increases in weekly rents of Retail Price Index (RPI) + 0.5% to increases of Consumer Price Index (CPI) + 1%
- Removing the flexibility available to landlords to increase weekly rents by an additional £2 per week where the rent is below the rent flexibility level (i.e. the target rent plus the relevant tolerance) and rent cap
- Making clear that rent policy does not apply where a social tenant household has an income of at least £60,000 a year.

This document sets out the National Housing Federation's response to the specific questions in the consultation. We also outline our wider views on the proposed new rent settlement and the potential impact on housing association businesses and their capacity to continue to develop affordable homes.

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## **2. Executive Summary**

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The National Housing Federation welcomes the certainty that a ten year index-linked rent settlement provides. This will give housing associations the confidence and resources they need to plan for future development. It will also give lenders and investors the certainty they need to continue to work with housing associations to provide finance for the development of new homes.

However, the end of rent convergence would put this new confidence at risk as it will significantly reduce the future rental income for many housing associations. For some, this will impact on loan agreements, risking the viability of their whole organisation, and for others it will severely constrain the number of new affordable homes they are able to build.

Following the Spending Round announcement, strong representations were made by the sector on the consequences of ending rent convergence. We are disappointed Government confirmed their intention to pursue the proposal to end rent convergence in the consultation.

## **3. Response to consultation questions**

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### **Question 1 – What are your views on the Government’s proposed policy on social rents from 2015-2016?**

#### **Proposal**

The consultation sets out the Government’s proposed rent settlement for social housing from 2015 onwards. The Government are intending to introduce a 10 year settlement for social rents from 2015-16, with annual rent increases of CPI + 1%.

The consultation confirms that the new settlement will not include the flexibility for landlords to increase rents by up to an additional £2 above the increase in formula rent, where the rent is below the rent flexibility level (i.e. the target rent plus the relevant tolerance) or rent cap. In short, rent convergence through annual rent increases will end

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from April 2015-16 and annual increases in rent will generally be limited to CPI + 1% regardless of whether the property is at target rent. DCLG have said the policy change is intended to ensure all social tenants see their rents increase on the same basis and it will also help control the housing benefit bill.

Social rents will continue to be set on the current basis, where a formula rent is calculated based on the current formula, and using values currently used for national average rent and capital value (as at January 1999 prices) and manual earning levels. DCLG have said they want to maintain the inflation-linked formula, and the values used, to provide stability to tenants and landlords. While the consultation makes it clear that convergence will end from 2015, target rents will continue to exist and the general expectation that housing associations set rents with a view to achieving - as far as possible - conformity with target rent would still apply.

### **Federation response**

The Federation welcomes the certainty that a ten year index-linked rent settlement provides. A long-term settlement with annual rent rises above inflation is a very positive step and will give housing associations the confidence and resources they need to plan for future development. It will also give lenders and investors the certainty they need to continue to work with housing associations to provide finance for the development of new homes. However, the end of rent convergence will significantly reduce the future rental income for many housing associations and will undermine the confidence afforded by the new settlement. For some, this loss of income will impact on loan agreements and risk the viability of their whole organisation, for others it will severely constrain the number of new affordable homes they are able to build.

In order to better understand the impact on housing associations of ending rent convergence, we sent a survey to all Federation members in the summer of 2013. The evidence collected through that survey has informed this consultation response.

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Previously DCLG said 'they expect most landlords to have achieved convergence by 2015. By that point, the rent convergence policy will have been in place for almost 15 years – this is a significant amount of time for landlords to make full use of the rent flexibilities the Government have provided, and most have done so.' However, as our survey showed, and as acknowledged in the consultation document, much of the housing stock transferred from councils to housing associations was subject to rent protection at the time of transfer. Many housing associations have been unable to use the full period of rent convergence and consequently still have a significant number of properties below target rent. Similarly, some properties transferred had particularly low social rents and even using the full period of flexibility has not afforded them sufficient time to achieve full convergence with target rents. We know housing associations that will have properties below target rent by 2015-16 are thinking carefully about the impact this will have on their viability and capacity and business plan assumptions.

Our survey showed that for many housing associations the impact will be manageable within the context of their current business plan. However, there are a number of housing associations where the consequences for viability and / or capacity could be significant. While it is difficult to suggest the total value of the net rental income foregone across the sector, we have several examples of housing associations where the loss exceeds £20 million over the 10-year period.

We are aware of housing associations that will have 70% to 90% of their housing stock not at target rent by 2015-16, most of whom have used the full flexibilities for increasing rents. For these housing associations the cumulative impact in terms of lost rental income will clearly be great. For some housing associations convergence would need to continue until at least 2025-26 for them to meet target rent on all of their stock. In most instances these are large scale voluntary transfers (LSVTs) whose rents were subject to a rent guarantee at the point of transfer. The potential impact of the loss of convergence cannot be taken in isolation, with many of the hardest hit LSVTs also losing capacity through increased 'Right to Buy' sales.

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A number of housing associations have advised us this will present serious viability problems. This is largely because this lost rental income means they will breach their lending covenants (cashflow, interest cover and debt per unit); their peak debt level will be exceeded and pushed back; they will be unable to meet loan repayment profiles; or, take on additional borrowing to make good the difference. In some instances the end of convergence presents immediate viability problems. In others, this could lead to viability issues where housing associations are unable to re-negotiate with lenders. If a housing association becomes unviable in these circumstances, this could have consequences across the sector, with potential wide-spread implications for funding and the pricing of debt. As set out in the consultation, the Regulator can offer time-limited waivers from adherence to policy to support an association to remain financially viable. However it goes on to say, the Regulator expects an association to have looked at all other solutions for addressing its viability, including reducing non-core spending. Defining waivers in such narrow terms will not help housing associations meet the challenges presented by the end of convergence in a way that allows them to continue to operate effectively, deliver services to tenants and meet their business plan aspirations. In short, they may continue to be financially viable in the strictest sense, but they may not continue to be effective businesses.

The loss of convergence will have a cumulative impact in terms of lost rental income. A large number of housing associations have concerns that this loss of income will, inevitably, mean a reduction in their capacity and their ability to invest in developing new homes or to fund existing community services. We know associations in this position are thinking carefully about the impact this will have on their future plans. In this sense, the end of rent convergence is inconsistent with the Government's stated ambition to increase housing supply. As set out above, the ending of rent convergence will particularly impact on LSVTs. Their potential to become major developers in the short-term has rightly been noted and ending rent convergence means the opportunity to ensure this potential and capacity can be accessed to deliver the next programme could be significantly compromised.

While we understand that until DCLG announces the new rent policy following the consultation period there is no decision that can be challenged by way of Judicial Review,

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we have sought initial advice from Devonshires Solicitors and believe the proposal to remove the existing convergence element of the rent policy for social housing has a number of legal implications.

Our initial legal advice considers whether housing associations have been led to believe that they will be entitled to increase social rents using the current convergence formula until target rents are reached.

So-called 'deemed compliance' arises from the Rent Standard, in place since April 2012, which states that were there is non-compliance with the Rent Standard housing associations should:

*'check whether there is deemed compliance about time for meeting the date for convergence. The Rent Standard places limits on the amounts by which rents can be increased each year within the allowed flexibility of target rent levels. Those limits might mean it is not possible for a particular PRP to achieve target rents by 31 March 2012 (or 2013 as appropriate). Where that is the case, the PRP's rent plan should demonstrate the date by which, taking into account the allowed flexibility of target rent levels, target rent will be achieved. The consequence is that this date could be beyond April 2012 (or 2013, as appropriate). In such cases, this will be the date for achieving convergence with target rents. Specific agreement from the Regulator to that date for compliance was not required and the PRP is deemed to be compliant.'*

Deemed compliance implies that housing associations will be able to continue to increase rents in line with the rent plan, until target rent will be reached, and it is clear this does not need to be done by a certain date.

Our advice also suggests there are substantive legitimate expectations that arise from provisions in the Rent Standard and the implementation of stock transfers. There are particular implications arising from the valuation of stock at the time of transfer, which in many cases was based on an assumption around achieving convergence with target rent,

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and the Regulator's involvement in the transfers, in particular in approving business plans. The lack of an express waiver for these LSVTs should not prevent them continuing to converge beyond 2015 where the Housing Corporation or any successor body was directly involved in their rent setting plans (as part of their business plans) or the valuation of the stock at transfer was based on target rent being achieved in the future. LSVTs in this situation can claim to have a legitimate expectation that they would be allowed to follow through with convergence.

If the Regulator resiles from a substantive legitimate expectation, arising from deemed compliance or otherwise, our advice suggests that a judicial review claim has good prospects of success as matters stand.

We believe a significant number of housing associations have either relied on deemed compliance or had legitimate expectations of convergence continuing, or both, and have rent plans and business plans which assume continuing increases until well after 2015.

Our advice also outlines the wider issue of the fundamental objectives of the Regulator, which need to be considered in the context of the impact on housing associations' ability to maintain their building programmes. These objectives include:

- To support the provision of social housing sufficient to meet reasonable demands (including by encouraging and promoting investment in social housing)

If the Government proceeds with the policy to end convergence as currently proposed, then that would potentially put the Regulator in breach of its fundamental objectives, which could give rise to good grounds for a public law challenge based on Wednesbury unreasonableness, irrationality and perversity.

It is also important to note the responsibility of boards is to protect the solvency and viability of their association and this is reflected in the HCA's Governance and Financial Viability Standard. In addition, paragraph 1.5 of the existing Rent Standard specifically refers

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to cases where the application of the standard might put a provider at risk of failing to meet existing commitments such as banking or lending covenants, and states that the regulator may allow time for the provider to bring itself into compliance.

The consultation confirmed that properties can continue to be re-let at target rent on vacancy as is currently the case and, for developing housing associations, there will be a greater push on converting social rent homes to affordable rent on re-let. While this is welcome, it does not deal with the issues outlined in this response in any significant or meaningful way, particularly as the turnover of social rented homes has been falling in recent years, with re-lets now running at 5.2% of total stock per year. So, a gap in rental income will still remain.

## **Question 2 – Should the rent caps be removed?**

### **Proposal**

Rent caps currently set an absolute cash limit on the rent that can be charged, based on the number of bedrooms in a property. Where the rent cap is below target rent for a particular property, it is expected the rent cap will determine the upper limit of the rent that can be charged. As set out in the consultation, Government is considering whether to remove rent caps in the new rent settlement from 2015-16.

### **Federation response**

The Federation supports the removal of rent caps in the new rent settlement. We believe this will give housing associations more flexibility and control over the rents they charge and will allow them to better manage their businesses. Removing rent caps would also help simplify what is a complicated rent policy for housing associations and tenants.

## **Question 3 – Do you agree with the move from basic rent increases of RPI + 0.5 percentage points to CPI + 1 percentage point (for social rent and affordable rent)?**

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## **Proposal**

The consultation sets out the proposed move from annual increases in weekly rents of RPI + 0.5% to increases of CPI + 1%

We understand the change to CPI is in line with a move across Government to use this measure, as far as possible, when an inflation linked index is used in policy. Government has said that in switching from RPI to CPI they also hope to put rents on a more stable footing. It has taken this action following the announcement from the National Statistician that the formula used to produce RPI does not meet international standards.

## **Federation response**

A long-term settlement with annual rent rises above inflation is a welcome and positive step for the sector and will give housing associations the confidence and resources they need to plan for future development.

The move to CPI + 1% will naturally lead to questions as to how this compares with the existing settlement of RPI + 0.5%. This will depend on future inflation, but over the last 12 months RPI has, on average, been around 0.5% higher than CPI, suggesting the new formula should give a broadly comparable rent increase in the short term. The inflation figures released in September 2013 showed RPI at 3.2% (which will be used to calculate rent increases in April 2014) and CPI at 2.7%. In the long-term, the difference between RPI and CPI is more uncertain and current forecasts suggest the gap may grow. Housing associations will need to factor in any potential fall in income over the long-term in to their business planning process. Government will need to be mindful of a fall in income for housing associations, be clear about the implications and ensure it is appropriately reflected in any future investment programmes. .

## **Question 4 – Do you agree with the definition of ‘household’ proposed?**

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**Question 5 – Do you agree with the definition of ‘income’ proposed?**

**Question 6 – In particular, should capital be included and if so, how?**

**Question 7 – Do you agree with the income period proposed?**

**Question 8 – What are your views on the proposed self-declaration approach?**

**Question 9 – Do you agree with how we propose to treat historic grant?**

### **Proposal**

In July 2012 the Government published a consultation paper setting out proposals to enable landlords to charge higher rents to social housing tenants with higher incomes. In the 2013 Budget Ministers restated their intention to take this policy forward, by allowing landlords to charge market rent to social tenant households with incomes of at least £60,000 per year.

DCLG provided further information on how it intends to implement the policy in its summary of consultation responses, published in July 2013. They explained they would take steps towards removing the regulatory controls preventing private registered providers charging market rents to social tenant households on incomes of at least £60,000 per year. It is worth noting that there is currently no intention to make it a mandatory requirement that housing associations adopt this ‘pay to stay’ policy, rather DCLG will remove the restrictions that currently prevents them from doing so.

The recent consultation set out further detail of how DCLG intends to support landlords to implement this policy. Currently housing associations have to adhere to rent regulation, which expects them to set rents for social housing based on the formula, unless a specific exemption is provided. By introducing a new exemption from these expectations for social tenant households on incomes of at least £60,000, this will remove the regulatory control that currently prevents social landlords from charging these tenants market rent.

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The consultation also set out Government's intention to find a legislative opportunity to introduce a requirement for social tenant households on incomes of £60,000 or more to declare this to their landlord, along with appropriate sanctions and other changes to the primary legislation that might be needed. Where a tenant made a declaration, the landlord could decide whether to charge the tenant up to full market rent. The consultation invites respondents to give a view on the proposed self-declaration approach, along with other specific aspects of the policy, such as the treatment of historic grant and the use of any additional rental income generated.

To create this exemption, DCLG has set out in the consultation what it means by 'income' and 'household' and has invited respondents to say whether they agree with the proposed definitions.

### **Federation response**

Overall the Federation welcomes the confirmation that it will not be mandatory for housing associations to implement a pay to stay policy for their existing or new tenants. As independent businesses that understand their tenants and manage their own revenue and assets, housing associations are best placed to take a view on whether they can make this policy work for them.

Giving the potential cost and administrative barriers associated with implementing a pay to stay approach, and the relatively small number of high income tenants in social housing, we think the number of housing associations that chose to use the flexibility offered by this policy will be very limited. In this context, we have not commented on the detailed proposals in the consultation for how the policy should be implemented if housing associations should chose to do so.

Broadly we think the definition of household, income and income period and the treatment of historic grant proposed in the consultation look sensible. We also support the principle of tenant self-declaration, rather than housing associations having to collect income data

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from all tenants. However, while we understand primary legislation requiring 'high earning' tenants to declare their income will set a clear legal framework for landlords that chose to implement a pay to stay approach, we are concerned this could lead to housing associations being required to play a role in following up and issuing sanctions for those tenants suspected of not declaring.

#### **4. Conclusions and recommendations**

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While we welcome the certainty that a ten year index-linked rent settlement will provide for housing associations and their lenders and investors, we have significant concerns about the impact of ending rent convergence on the long-term capacity and viability of some housing associations.

Based on our view of the new settlement, and in particular our concerns on the ending of rent convergence, and following the legal advice we have received, the National Housing Federation strongly recommends that Government:

- Confirms the social housing rent settlement of CPI + 1% for ten years, from 2015-16.
- Retains the current flexibility for housing associations to continue to increase rents by an additional £2 per week to help achieve target rent.

We understand the Government is committed to ending rent convergence but this has to be balanced by the need to ensure the viability and capacity of housing associations is not seriously compromised. We would be happy to talk to Government and the Regulator in more detail about how the new rent settlement can best achieve the aim of accessing capacity from across the sector and ensuring this is used to help increase affordable housing supply.

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