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Living rent methodology

Part one: Methodology for determining a Living Rent

Introduction

Despite the increased numbers of people relying on rented housing, there is a lack of a national strategy with regard to renting. This is particularly apparent in relation to households on low incomes, where the government's various initiatives – when combined with their policies in relation to rents and housing benefits – are pulling in different directions. A particular issue in terms of increasing rents, leading to increased pressure on the housing benefit bill.

One of the key premises for this research is the need to re-establish the crucial links between housing and the labour market and between rents and people's ability to afford them. We therefore want to ensure that there is a below-market rented sector that is genuinely affordable for low-income working people and therefore reduces the reliance on housing benefit payments.

This research explores what a rent-setting mechanism might look like that delivers these aims.

The key aims in our methodology are to:

- Identify an index of earnings for low-income households to which rents could be linked
- Identify a means of linking this index to the differing composition of households in different-sized properties
- Identify the starting rents which would be charged on the basis of this index
- Identify the mechanism by which rents would be increased

The work for this research was undertaken during early 2014 and the figures and data in this paper are based on what was available at that time

Original basis for social rents

It is worth restating the original basis for the current rents in operation for social landlords, which was introduced in 2002. This rent formula consisted of 30% of the rent levied being based on the existing use value of the property and 70% based on average weekly manual earnings, based on county data derived from the New Earnings Survey. There was also a weighting for the number of bedrooms in the property.

These were annually uprated by RPI plus one per cent initially and then plus half a per cent, rather than a by a link to earnings or a mechanism for reassessing the capital value. Therefore, the annual means of increasing rents was not linked to the base concept.

This formula for setting social housing rents has persisted for 13 years. However, there are now a number of issues which mean that this no longer focuses clearly on affordability:

- The above-inflation rent rises at a time when earnings growth has been weak and has undermined the formula's original link to earnings

- The introduction of higher Affordable Rents for many new homes and relets, as part of the development framework operated by the Homes and Communities Agency and the Greater London Authority, which are being charged for properties still being allocated principally to people on very low incomes
- There is now improved, more localised data on earnings available than was the case when the formula was originally drawn up
- The differentials for bedroom size are too flat and distort incentives in terms of both pricing for more space for tenants and developing new homes

Over the past 13 years we have also seen a wider variety of affordability problems develop for people on a range of incomes, which housing policy needs to accurately reflect. Affordability is also very different in different markets. There is now a wider range of needs based on affordability than was the case when the formula was introduced.

The use of the formula has also meant that social landlords have generally not had to develop rent-setting and allocations policies linked to local circumstances. This has had advantages in terms of consistency but does not allow landlords to develop approaches linked to needs and incomes in the local markets in which they operate. This has begun to change as landlords have introduced Affordable Rents.

This project aims to consider what an alternative framework for rents for social housing would look like. Such an approach needs to involve both a modernised formula linked to the incomes of those on low earnings - which this research aims to do - and consideration of how this might underpin more sophisticated rent policies by landlords.

Our starting point – what rent?

The overall aim of this project being to test the idea that housing association and local authority rents should be affordable for low-income, working households. As a result, finding a suitable basis for rents is crucial. We are calling the rent we identify the Living Rent (LR).

Ideally, to do this we would be looking for a figure for household income. There are however two conflicting challenges:

- The real circumstance of households vary so much – wages, number of people earning, tax, National Insurance, child care, benefits, location, costs, etc – that it is hard to reflect this complexity within a practical implementable rent policy.
- It is important to have a level of simplicity and transparency and this will require having an available income data source which is regularly updated, has localised information and which everyone can access

Therefore, the aim is to find a transparent mechanism that will broadly reflect the type of households accessing social housing.

Moreover we are looking to move away from having a link to capital values. The purpose of social housing is to provide homes for people the market cannot supply. Clearly, capital values are driven by the market, in which social tenants cannot participate, and therefore a link to capital values is inappropriate.

One option would be to move to a system where rents are linked to the income of individual tenants. However, a review of international experience shows that tying rents directly to incomes raises concerns about work incentives and social mix, as well as increasing administration costs.

Basic proposition

The starting point for a basic proposition is that Living Rent should be affordable for a household with someone in full-time employment, working the average number of hours worked per week (including overtime) and earning around the minimum wage.

The minimum wage for someone working the national average 39-hour week is:

Min wage	Hourly rate	Weekly	Annual
2013-14	£6.31	£246	£12,797
2014-15	£6.50	£253	£13,182

The intention is therefore to relate the base starting point for rents to this figure.

It is important to be clear here that in linking rents to earnings we are seeking to establish a crucial link between housing and the labour market. However, in doing so, the rents arising would be aimed at improving the ability of all people on low incomes to afford them – whether they are working or not.

Using ASHE

The best mechanism for understanding localised earnings and which is readily accessible is the Annual Survey of Hours and Earnings (ASHE), compiled by the Office for National Statistics. This looks at individual – rather than household – earnings.

The lower-quartile, average national figure using ASHE figures for all employee jobs for England, 2014[1] is £253.60 per week. (The second-lowest decile is £215 per week). As this equates to the earnings of someone in full-time employment, working the average number of hours worked per week on the minimum wage - our basic proposition - we therefore use the ASHE lower-quartile figure in this work as the basic earnings figure for calculating Living Rents.

However, this must be adapted to reflect:

- The differing composition of households in different-sized properties
- Allowing for the fact that household income for low-paid families with children is likely to be enhanced by benefits and tax credits

Therefore, the key issue is to find a mechanism to use ASHE in a way that adapts to reflect these factors.

Equivalisation

We used an equivalisation methodology to enable us to use ASHE in a way that adapts to reflect the factors in the bullet points above. Equivalisation scales are used to show how the incomes of households are compared, adjusting a household's income for size and composition.

1 ONS: Table 8.1a Weekly pay - Gross (£) - For all employee jobs 2014

There are different models of equivalence. The OECD-modified equivalence scale is the standard scale for the Statistical Office of the European Union (EUROSTAT) and several government departments in the UK use it for key household income statistics[2] This produces the scale as shown below:

OECD-modified equivalence scale as applied by household composition

Type of Household Member	Equivalence value
First adult	1
Additional adult	0.5
Child aged 14 and over	0.5
Child aged 0-13	0.3

Equivalence and rents

The equivalence approach is designed to adjust cost of living – rather than income – in relation to household size and composition. It is therefore not specifically designed to relate rents to income.

It can however be a suitable proxy to relate rents to household and property size, given that:

- It gives a base point of a household with one working adult
- A household with one child and one adult earning the ASHE national lower-quartile wage would receive one third more in income from the basic tax credits and child benefit
- A household with two children and one adult earning the ASHE national lower-quartile wage would receive around 53% extra income from the tax credits and child benefit
- Given the difficulties low-income households experience finding work with the number of hours they want, it seems logical to make an allowance for the fact that additional adults may be working less than full-time. We therefore score 0.5 for an additional adult

Defining the appropriate scale for size of property

Looking at the latest Continuous Recording of lettings in social housing in England[3] (CORE) Data for working-age households moving into general needs properties, we can gain an idea of who has been moving into which size of property:

One bedroom

86% of the lettings of one-bed properties to working age adults were to single adults.

Therefore, it is clear the rent should be focused on a single adult. Giving us point 1 on the equivalisation scale

2 http://www.ons.gov.uk/ons/rel/family-spending/family-spending/family-spending-2012-edition/art-chapter-3--equivalised-income.html

3 https://core.communities.gov.uk/

Two bedroom

For two-bed properties there was much more of a mixed picture with more than three-quarters having children or more than one adult.

Type of household	Proportion of lettings	Equivalisation score
Lone parent	39%	1.3
Single adult	23%	1
Multi adult	18%	1.5
Multi adult with children	19%	1.8

The average score was therefore: 1.35

We have made the assumption that for a two-bedroom property there would be one adult with one child under 14. Giving us 1.3 as the appropriate point on the scale.

Three bedroom

Families predominate here with both lone parents and multi-adult households with children accounting for nearly 80% of lettings. A further 17% are multi-adult households with no children.

We do not have details of the number of children in households so we make the assumption that for both lone parent and multi-adult household categories these would be split equally between one and two children households.

Type of household	Proportion of lettings	Equivalisation score
Lone parent - one child	20%	1.3
Lone parent - two chil/n	20%	1.6
Multi adult	17%	1.5
Multi adult - one child	20%	1.8
Multi adult - two chil/n	20%	2.1
Single adult	3%	1.0

The average score was therefore: 1.6

We have made the assumption that for a three-bedroom property there would be one adult with two children under 14. Giving us 1.6 as the appropriate point on the scale.

Taking the CORE information and combining it with the OECD scale we are using:

Bedroom size	Household size	Equivalence rating
One bedroom	Single adult	1
Two bedroom	One working adult and one child	1.3
Three bedroom	One working adult and two children	1.6

Percentage of incomes

There is no generally agreed method for determining what percentage of earnings/income should be used for assessing the affordability of rents for social housing. Different organisations or studies use a variety of proportions and many studies focus on net income or use a residual income methodology. There is, however, a general bunching of views around 25% to 35% of net income

JRF's *Monitoring poverty and social exclusion* [4] report shows that the poorest households spent on average 29% of their income on housing. This is twice as much as those on average incomes (15%) and three times the level of the richest fifth (9%). This study found that social renters in the poorest fifth spend on average 33% of their income on housing.

As it is not the intention of this study to see social renters worse off, we should be looking to aim our proportion of income taken by rent at the current average of 33% of gross household income.

However, as our starting point is earnings and that using equivalisation only provides a proxy for gross household earnings for those with children, we need to discount the 33% gross figure.

There are various views as to the practical difference between net and gross incomes. We are using Savills modelling of tax take for lower-quartile household income. This explores the real gap between net and gross incomes, taking into account both tax and National Insurance on the one hand and benefits and tax credits on the other. This shows a 5% gap between the equivalent percentages of net and gross income, which means that the 33% of gross earnings translates into 28% net.

We have therefore used 28% of net earnings as the basis for calculating the Living Rents for use in this project.

A Living Rent

We have used a model based on:

- Annual Survey of Hours and Earnings (ASHE) lower-quartile earnings
- Adjustment for property size and household income, using a recognised equivalence model
- Starting rent set at 28% of net earnings
- Rents based on local authority areas

To provide what we describe as a Living Rent for one, two and three-bed properties.

Service charges are an important aspect of rent setting. At the present time these are outside the model used for setting social rents. The modelling here takes the same approach. However, landlords developing affordability approaches based on Living Rents would need to consider service charges as part of the whole affordability package.

4 MacInnes, T.et al Monitoring poverty and social exclusion 2014 York: JRF

Health warning

It is important to bear in mind that, not only is it impossible to produce something which takes into account the different circumstances that people find themselves in, but individual and household affordability will change over time. Moreover, many working households are finding it difficult to get the number of hours which they would want to work.

Any basis for creating a link between earnings and rents will therefore inevitably be a compromise. However, the logic of this project is that it is better to have such a compromise – which is at least generally linked to affordability – rather than the current incoherent situation. The present arrangement is problematic for tenants, landlords and, indeed, the long-term ability to provide the right number of homes to ensure that low-income families can be decently housed.

Part two: Business Planning and Living Rents

We worked closely with seven landlords, who supplied us with information on their rents by local authority area and tested out the effects of Living Rents on their business plans.

The seven landlords work in differing markets and geographies, shown below. This involves two in Yorkshire, two in the Midlands, two in London and the South East and one in the South West. We looked principally at housing associations to best enable effective comparisons and to reflect that they are currently the major developers of new housing for people on low incomes. However, we did include one local authority landlord to explore the specific issues which authorities face and had discussions with two experts in local authority housing finance.

Landlord	Type	Area of operation
A	LA	Yorkshire
B	HA	Yorkshire
C	HA	West Midlands
D	HA	East and West Midlands
E	HA	West London and in counties round London
F	HA	Inner and outer boroughs in the east of London and in Essex
G	HA	South West

Findings from rent data

Appendix one provides a set of rents for 17 selected local authority areas from the landlords involved, based on 2013 data. These 17 areas were chosen because they contain a sufficiently high concentration of the relevant landlord's stock in that local authority. From these we can draw out some key points about rent distribution and affordability.

Property size

One-bedroom properties – in all areas, except Rotherham, Sheffield and Charnwood, Living Rents are lower than the current average social rents. This suggests that there is an issue around the affordability of smaller properties for people in work and on low incomes at the present time.

Two-bedroom properties – Living Rents are lower than average social rents in most areas, the exceptions being: York, Rotherham, Sheffield, Birmingham, Tower Hamlets and Richmond-upon-Thames.

Three-bedroom properties – This presents a mixed picture, with:

- Living Rents being higher than average social rents – and indeed similar to or above Affordable Rents – in York, Sheffield, Rotherham and Newcastle-under-Lyme
- In Birmingham, Charnwood, East Lindsey, Cornwall and Tower Hamlets Living Rents are higher than social rents but lower than Affordable Rents
- In Devon, Newham, Redbridge, Waltham Forest, Hounslow, Reading and Slough Living Rents are similar to or lower than social rents
- Richmond-upon-Thames, with its very high earnings figures, has a Living Rent which is £27 a week higher than the average current social rent, but which is still around £200 a week less than lower-quartile private sector rents

Size differential

The rent differential that arises from using the equivalence methodology – whereby a three-bedroom rent is 60% higher than a one-bedroom property – is clearly making a significant difference. The current differential for social rents between one-bedroom to three-bedroom properties was in the range of 17% - 41% for the average general needs rents. Although, Leicester – which is not one of the 17 highlighted local authority areas – has a rent differential of 57%.

This obviously reflects the relatively narrow weighting for bedroom size in the original formula for assessing social rents. In this the rent derived from earnings and market data was then adjusted by: one-bedroom is 0.9; two-bedroom is 1; and three-bedroom is 1.05.

For market rents, there is much more of a rent differential, with a spread for lower-quartile private rented sector rents of 24% – 73% between one-bedroom and three-bedroom rents.

The larger rent differential under a Living Rent approach and the lower rents for smaller properties would seem to support a rationale of linking rents to incomes and encouraging people to live in properties that are appropriate to their needs.

It is worth noting there are potential considerations in relation to recent benefit changes. However, in terms of the £500 a week household benefit cap, an association in this study working in London has a rent ceiling of 45% of net income, or £225 per week, which it sees as being well within the current cap.

There may be more of a difficulty in relation to increases for larger properties in relation to the bedroom tax – where working age social tenants in receipt of housing benefit have this support reduced if they have spare bedrooms. However, given that existing tenants will remain on current rents, this could be seen as something that needs to be dealt with through allocations policies.

Affordable rents

What is clear from this work is that the current move to Affordable Rents for most new lettings is going to have significant implications on the ability of tenants to afford their rents and consequently on the rental income of landlords.

One obstacle to making firm comparisons is the relatively low numbers of Affordable Rents that are so far 'in the system'. However, the data that is available clearly confirms that Affordable Rents are generally higher than social rents, and in many areas significantly so.

In terms of the relationship between Affordable Rents and Living Rents, if we look at two-bedroom properties in our case study landlords then we can see that – while in Sheffield Affordable Rents are actually lower than Living Rents and for Rotherham only 3% above – there are significant differences in the rest of the country. This seems to confirm that in many parts of the country Affordable Rents are not actually affordable for households on low earnings.

The figures here also demonstrate the increases we are likely to see in the income of many housing associations if they move significant numbers of their properties to Affordable Rents (assuming those rents are collectable). Clearly though – given the point about affordability above – their income streams will become even more reliant on housing benefit support to some tenants than at present.

Differences in local earnings figure

As can be seen from the methodology for Living Rents, our starting point was linking the national minimum wage to the national ASHE lower-quartile rent. The average rent for a one-bedroom flat based on the ASHE lower-quartile figures for all employee jobs for England is £71 a week.

What the Living Rents methodology highlights are the differences between lower-quartile earnings in different markets. The extreme is Richmond-on-Thames with a one-bedroom rent of £108 a week. Clearly the Living Rents for Richmond are going to be problematic in terms of affordability for someone on the minimum wage.

In terms of these differences it is also not a simple case of North v South. In East London, a one-bedroom property in Tower Hamlets let at a Living Rent is £97 per week, while in nearby Newham it is £65 per week. In the East Midlands, a Living Rent for a one-bedroom property in Charnwood is £73 a week, while for East Lindsey it is £57 a week.

Clearly this does have implications in terms of whether Living Rents in areas with high earnings are really affordable for those on the minimum wage. This may therefore require consideration of some kind of ceiling to rents in areas with high earnings figures. This may also point to Living Rents being used as a benchmark within a wider change of rent policy to support landlords in assessing local affordability.

Total rent take

The total rent produced for these areas by adding up the individual rents for one, two and three-bedroom properties in each local authority area shows that the overall rent take from the current average rents is 4% higher than that for Living Rents. Looking at the profile of the landlords in this sample matched against the profile of social housing as a whole suggests that Living Rents would therefore appear to produce 2-3% less in terms of rent income than current rents.

2. Landlord business plans

The seven case study landlords provided us with information to establish what the effects of moving to Living Rents would have on business planning in each organisation.

What we asked the landlords to do:

1. Rents

Big bang
Consider the effect of applying Living Rents – rather than their current social and Affordable Rents – for the whole of the stock to their current business plan

Phasing-in
Consider the effects of phasing in Living Rents by turning all new lettings into Living Rents over the course of the business plan

2. Uprating rents

To understand the effects of the following growth in earnings figures and how these contrast with current Consumer Prices Index (CPI) assumptions:
- - Earnings growth of 4.25% p.a. over the business plan
- - Earnings growth of 1% p.a. over the business plan

The results of the modelling

Big bang or phasing-in?

As you would expect from the rent information above, there were very different business planning outcomes for landlords, depending on the relationship between their current rents and Living Rents. The actual position of individual landlords was principally a result of the markets they worked in and the level of earnings there. However, the differences in the size of properties in their portfolio and some of the decisions they had made about their own stock – for instance in terms of how far they were introducing Affordable Rents – also had an effect.

So for those organisations with Living Rent incomes higher than that projected for their current business plans, there are potentially gains from the big bang -depending on the level of rent uprating. However for landlords at the other end of the spectrum the opposite is the case, as can be seen from the table below.

Percentage variance to current business plan after 10 years 'big bang' scenario

HA	4.25%	CPI at point of research	1%
A	17.6	13.3	1.5
B	14.25	13	0.6
C	14.9	4.1	0.5
D	5.8	1.2	-2.2
E	6.8	-1.8	-4.3
F	-9.8%	-14.95	-22.38
G	-2.9	-6.6	-11.8

If we look specifically at the case of landlord F – who was the worst affected landlord – under the 'big bang' scenario its annual rent income would fall from £41.7m to £35.5m in year one, a 15% drop. Even allowing for the higher inflation rate assumption then it would be 15 years before rents came back in line with the base plan and 25 years before the shortfall was fully recovered.

The effect of the 'phased' scenario demonstrates the less dramatic changes to business plans, as can be seen in the table below. As we can see the effects of the Consumer Prices Index - 3% – has no winners, but the range of reductions is a relatively modest -0.1 – -2.5.

Percentage variance to current business plan after 10 years 'phased' scenario

HA	4.25%	Current CPI	1%
A	5.2	-0.1	- 9.2
B	Not available	Not available	Not available
C	9 .4,-	0.1	- 3.6
D	3.1	-1.3	- 4.7
E	0.05	-1.4	- 2.3
F	- 2.2	- 4.0	- 6.5
G	- 1.9	- 2.5	- 3.1

Overall a 'big bang' approach looks unrealistic because it means that, while there are winners, the negative business plan effects for some landlords are severe. Moreover the landlords who would lose are generally in the areas of highest demand.

A phased approach would still have its challenges. The result showed that landlords would be able to manage a move to Living Rents without endangering their viability. However for the landlords who are adversely affected it would have an impact on their level of development. The effect of better affordability would therefore be less development.

Two things would help deal with the challenges which landlords would face, particularly in terms of retaining development capacity:

- Landlords – particularly in high value areas – being able to mix relets between Living Rents and intermediate rents, based on local affordability
- If – as we argue elsewhere in this work – grant rates were increased, that would have a significant positive impact on landlords' business plans, particularly those in high-rent areas

What phasing?

The assumption we have made for this work, is that phasing-in Living Rents would involve Living Rents being applied to all relets and new properties developed with government support.

It has been suggested that Living Rents could just be an option for new development. This achieves a supply of new homes explicitly aimed at low-income groups. However, the real issue of affordability for tenants is at what level the rents of the 290,000 new lettings by social landlords each year are set. If a policy does not address the affordability of relet homes it means existing tenancies at social rents, new properties at Living Rents and relets at Affordable Rents (or what rent a landlord chooses, depending on government policy).

This would mean that - rather than achieving a more coherent and sustainable rents policy based on affordability – there would be a more incoherent situation than at present, while at the same time not really addressing the issues of affordability that we have highlighted.

It is therefore important that Living Rents should not become another ‘layer’ on top of or alongside other nationally determined rents. If affordability is to be really addressed then social landlords need to be able to do it by properly assessing the relationship between their allocations, local earnings/incomes and the rents they charge.

Living Rents could play a key role in this to help develop a more sophisticated and flexible approach to enhancing housing affordability.

Loans and valuations

Our main focus for the work with landlords was on the impact of Living Rents on their rental income and on their business plan. However, there are potentially wider effects.

A concern expressed by two associations in this study was the need to have discussions with lenders regarding the impact of Living Rents on loan covenants. The financial freedom of housing associations is still significantly constrained by the need to avoid any action that would risk a breach – or the obligation to seek re-negotiation – of loan covenants on low-margin debt, arranged prior to the financial crisis. Funders will generally seek accelerated debt repayment and/or re-pricing of loans to higher prevailing margins in such circumstances. The normally very high cost to housing associations of such actions serves to constrain choices or render alternative strategies unviable.

This aspect is crucial, as it would be nonsensical to introduce a system that led to widespread reconsideration of the way the sector is currently privately financed. This is particularly so given the other existing challenges, such as the introduction of the Universal Credit, potential alterations to right to buy and the removal of the previous rent convergence policy.

The other key area of concern expressed was in relation to stock valuations. For the landlords that would have significantly reduced income from Living Rents there is an issue about whether this reduced income would lead to reduced valuations of their homes. One of the associations in this study said: ‘A reduction in valuation would hinder our ability to borrow, by requiring additional properties to be used as security on existing debt, thereby limiting the amount of spare security capacity (often a more restrictive factor on borrowing than gearing) for future development funding.’

However, there was a perception that, while this issue could be problematic in terms of the ‘big bang’ approach, there was the potential to manage this effectively through the alternative phased approach.

The issue of covenants relating to interest cover was not raised as a problem. Indeed, landlord G which – as can be seen from the table above – would have its income adversely affected by moving to Living Rents, found that applying Living Rents to all new development still meant that interest cover remained above its internal threshold of 125% and well in excess of lender threshold of 105%.

Local authorities

There is a potential issue in relation to how Living Rents relate to the self-financing settlement for authorities. Theoretically this could be seen as triggering a reopening of the settlement, as it would have implications for the mechanism for moving debt between authorities.

In practice, phasing-in Living Rents through new homes and relets should not mean an alteration on the overall settlement amount for local authorities. In addition, given that many councils took out long-term, cheap loans as a means of funding the settlement in 2012 and that a number of years have elapsed since the settlement and before many rents have moved to the new system, we do not envisage a wholesale change.

However, for a local authority that is close to hitting the debt cap on its Housing Revenue Account and where Living Rents are less than current rents, there are clearly issues to be faced, which may need some transitional measures.

Uprating Living Rents

The mechanism by which rents for existing homes are increased annually is important, but the value of a landlord's rental stream is more dependent on the overall level of rent increase than relet rates. A 1% change in relets has a relatively small impact on values compared with the effects of rent increases across a landlord's stock.

Uprating scenarios

The logic of what we have done in basing the rents on earnings suggests that rents should be uprated annually, in line with movements in the relevant lower-quartile ASHE indices. We looked at three scenarios for earnings growth as the basis for uprating rents:

- **Scenario one:**

The Office for Budget Responsibility has forecast that earnings will increase over the next four years as follows:

Year	2015	2016	2017	2018
% increase	4.1	4.6	4.7	4.5

In this scenario landlords used a 4.25% increase in earnings as the basis for increases to the Living Rents

- **Scenario two**

To consider what living rents would look like if uprated by landlords' estimates of **CPI+1% at the time the research was undertaken.** This was generally a figure of 3%.

- **Scenario three**

It is also important to consider what a pessimistic scenario might look like, given that lower-quartile earnings may continue to increase at a lower rate than for middle-income and higher earners.

In the years from 2008 to 2013 lower-quartile earnings increased by 5.5% - just 0.92% per annum.

For the third scenario we therefore asked our test landlords to use increases to the Living Rents of **1.0%** a year

The table below shows the difference in rent income from these three scenarios:

Difference in rent income from rent uprating for different earnings growth % on the basis of 'phased' scenario after 10 years

HA	4.25%	Current CPI	1%
A	£384,118	£362,623	£331,080
B	Not available	Not available	Not available
C	£452,642	£413,066	£398,754
D	£1,021,000	£1,002,000	£943,000
E	£771,642	£760,503	£753,747
F	£467,788	£459,424	£447,257
G	£1,009,270	£1,002,428	£996,607

The advantage for landlords of the current CPI+ arrangements is they have a guaranteed income, which has a link to the inflation level which they are likely to face and is a sufficiently prudent basis for creating long-term financial commitments.

However, if the OBR is correct and earnings do significantly increase in the near future, then landlords may get larger rises than they would under CPI+1%. Until 2008, the annual increase in weekly earnings was averaging around 4% each year and, in all but two years between 1997 and 2008, was averaging more than RPI. However, it is important to bear in mind that some commentators believe that earnings at the lower end of the scale will not increase as rapidly as median earnings.

In the workshops we held with social landlords, lenders and other interested parties there were concerns that lenders were likely to be nervous about moving away from inflation-linked rises, principally because:

- The pension products that their lending to housing associations supports were also linked to inflation indices
- Wages have been more volatile than inflation indices in recent years

Taking this into account, linking Living Rents to CPI for the first five years and then rebasing rents on ASHE changes during those five years seemed a practical option. This might take the form of rebasing all a landlord's Living Rents every five years, or it could be a rolling programme of 20% each year. It may however be necessary for a rent floor to apply so that rents remain flat at rebasing, rather than fall, until they increase past that rent floor once again.

One option suggested in the course of the research was that landlords should also be able to see their Living Rent average across their stock as an 'envelope' – rather than a precise calculation for rents – and be able to vary individual rents within that envelope. This would give landlords some flexibility in terms of their knowledge of local circumstances and the relative attractiveness of particular areas or types of properties, while maintaining overall income levels.

Living Rents and the wider policy environment

As well as looking at the business plans of social landlords, we tested the concept of Living Rents through discussions with local authorities, lenders and representatives of national bodies. The consistency of a rent formula based on clear principles was welcomed – unlike the current confusion over affordability – and the potential for a move away from an increased reliance on housing benefit was especially popular.

We also found considerable support for the Living Rent proposal in terms of linking starting rents to incomes and encouraging people to live in properties that are appropriate to their needs.

This all suggests that it would be possible to introduce a Living Rent approach which would improve affordability and not be detrimental to the business plans of social landlords (although without changes to grant rates it could restrict the ability of some landlords to build homes).

While we are confident in the conclusions from this work, how Living Rents are introduced in practice would need to be thought through in terms of the overall approach of government and providers.

Social landlords have generally not in recent years had to develop a rent-setting policy, given that rents have been set on the basis of a national formula. This has begun to change as landlords have introduced Affordable Rents and in response to stagnant wage levels and welfare reforms. In doing so they are focusing more clearly on the affordability of rents.

An alternative to Living Rents would be to put a duty on landlords to set rents that are affordable for their tenants. This would have the advantage of landlords having to be very clear in understanding the affordability issues of their tenants, but it is difficult to see how this could be policed without considerable administrative procedures by the regulator.

Therefore, in the final report we consider how Living Rents as an alternative, modernised formula for those on low earnings might underpin a framework for a more sophisticated approach to rent policies by landlords.

Appendix One: Rent profiles

	Average general needs rent	One-bed £/week	Two-bed £/week	Three-bed £/ week
York	Affordable	89	100	110
	Social	69	81	88
	Living Rent	68	89	109
	Lower quart/e PRS	114	137	161
Rotherham	Affordable	69	87	99
	Social	66	74	82
	Living Rent	65	84	104
	Lower quart/e PRS	80	93	102
Sheffield	Affordable	73	77	97
	Social	64	77	84
	Living rent	62	81	99
	Lower quart/e PRS	92	107	114
Newcastle-Under-Lyme	Affordable	79	86	99
	Social	70	79	88
	Living Rent	62	80	99
	Lower quart/e PRS	81	98	110
Charnwood	Affordable	77	102	124
	Social	75	95	106
	Living Rent	73	94	117
	Lower quart/e PRS	91	108	127
East Lindsey	Affordable	95	86	100
	Social	73	81	87
	Living Rent	57	74	91
	Lower quartile PRS	75	92	110
Birmingham	Affordable	86	102	119
	Social	76	91	99
	Living Rent	70	91	112
	Lower quartile PRS	97	115	127
Cornwall	Affordable	82	104	128

	Social	69	79	88
	Living Rent	58	76	93
	Lower quartile PRS	103	127	144
Devon	Affordable	81	102	126
	Social	71	84	96
	Living Rent	60	78	96
	Lower quartile PRS	98	125	149
Newham	Affordable	140	165	n/a
	Social	96	114	130
	Living Rent	65	84	104
	Lower quartile PRS	185	230	288
Redbridge	Affordable	128	160	187
	Social	97	118	138
	Living Rent	85	110	136
	Lower quartile PRS	162	203	265
T. Hamlets	Affordable	148	168	191
	Social	107	121	138
	Living Rent	97	126	155
	Lower quartile PRS	275	335	400
W. Forest	Affordable	152	181	n/a
	Social	95	112	128
	Living Rent	80	104	128
	Lower quartile PRS	179	219	285
Hounslow	Affordable	139	165	N/A
	Social	115	128	135
	Living Rent	84	109	134
	Lower quartile PRS	202	253	294
Richmond on Thames	Affordable	146	162	214
	Social	117	130	146
	Living Rent	108	140	173
	Lower quartile PRS	213	299	369

Reading	Affordable	120	160	165
	Social	98	120	135
	Living Rent	77	100	123
	Lower quartile PRS	150	183	208
Slough	Affordable	113	149	160
	Social	108	125	138
	Living Rent	79	103	126
	Lower quartile PRS	150	185	219

Sources

PRS – ONS Private rental market statistics 2012-Sept 2013

Average social rents were provided by the landlords involved

Affordable rents were provided by the landlords involved or derived from the Statistical Data Return