



*Mechanism for setting
Guideline Rents in Housing
Revenue Account subsidy
2008-09 and 2009-10*

Consultation



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1 Introduction

- 1.1.1 This document sets out the Government's proposals for how the Housing Revenue Account Subsidy System will operate over the next two years in so far as it impacts on local authority housing rent levels.
- 1.1.2 In 2006, following the three-year review of rent restructuring the Government, concerned over the unaffordable annual rent increases that might arise from the implementation of the findings of the review, introduced a 5% limit on local authority housing annual rent increases, whilst guideline rents increased at the greater rate required to deliver rent restructuring by 2012.
- 1.1.3 The 5% limit on actual rent rises was backed up by a mechanism for reimbursing local authorities for the loss of rental income in-year that an increase of only 5% would lead to. This loss was driven by the increase in guideline rents coupled with the inability of local authorities to raise actual rents to the level assumed by the HRA subsidy regime if the local authority wished to comply with the Government's policy of a 5% limit. In practice this policy and the mechanism of the Rental Constraint Allowance (RCA) kept rises in actual rents to no more than 5% in 2005-06 and 2006-07 whilst guideline rents rose by a greater amount.
- 1.1.4 The RCA comes to an end in 2007-08. We are now consulting on the way forward for 2008-09 and 2009-10 with the aim of agreeing an approach for setting local authority annual guideline rent increases for inclusion in the Housing Revenue Account (HRA) subsidy determination for 2008-09. Guideline rents are notional, rather than actual rents, but do influence the setting of local authority actual rents.
- 1.1.5 The aim of this document is to set out how the Government's current rent policy operates in relation to local authority housing and seek views on proposals for technical changes to the HRA subsidy regime that will impact over the next two years. This is notwithstanding that the Government may wish to take a wider view of rent policy and the operation and reform of the HRA in the light of responses to the housing Green Paper, *Homes For The Future: More Affordable, More Sustainable*, and the Hills and the Cave reports.

2 Background

2.1 Rent Policy and Rent Restructuring

What do we mean by 'rent'?

Three measures of rent are discussed in this document

Actual rent – *this is the rent charged by the landlord – the local housing authority – to the tenant. It is the rent the tenant pays.*

Guideline rent – *a notional rent and a feature of the HRA subsidy system. The guideline rent is the rent the HRA subsidy system assumes an authority is receiving for the purpose of calculating its HRA subsidy entitlement. It is generated by a formula, one of the determinants of which is the date at which all rents are expected to converge.*

Limit rent – *this is the maximum rent which the Department of Work and Pensions is willing to pay in terms of Housing Benefit for a dwelling.*

2.1.1 Local housing authorities are free to set their actual rents at whatever level they choose.

2.1.2 In practice, they will have regard to two factors:

- Limit rents, which are set by the Department for Works and Pensions and which provide a ceiling beyond which rent rebate subsidy is not payable. If the limit rent is exceeded, local authorities have to find the additional costs of any housing benefit payment over and above the level of the limit rent from their own resources;
- The relationship between guideline and actual rents. Guideline rents are a feature of the HRA subsidy system and form the basis of assumed income for the authority. Where a local authority sets its actual rents in relation to guideline rents will have an effect upon its actual spending power. If actual rent is greater than guideline rent, the authority generates extra spending power, if actual rent is below guideline rent, the HRA subsidy system is assuming that the authority is getting more rental income than it actually is.

2.1.3 Current rents policy assumes that through the process of 'rent restructuring' there will be eventual convergence between the rents in the local authority and registered social landlord (RSL) sectors. At this point limit, actual and guideline rents for a single authority should all have the same value.

2.1.4 Following the implementation of the recommendations of the review of rent restructuring in April 2006, it was considered by Ministers that the potential increases in actual rent levels implied by the proposed increases in guideline rents would be unaffordable for tenants.

- 2.1.5 Ministers decided they would mitigate the impact of potential annual rent rises by asking local authorities to increase actual rents at levels lower than implied by guideline rent increases. This was achieved by introducing the RCA for 2006-07 and 2007-08. The RCA was a feature of the HRA subsidy system which reimbursed local authorities for any loss of income arising from lower than anticipated rent increases. The RCA finishes at end of the current financial year.
- 2.1.6 In the longer term Ministers will consider their overall rents policy in the light of the recommendations of the housing Green Paper, *Homes For The Future: More Affordable, More Sustainable*, the Cave Review on housing regulation and in the context of taking forward further work arising from the Hills Review. Each of these may have implications for future rents policy and will have implications for the future reform of the HRA and HRA Subsidy system, not least issues surrounding ‘self-financing’ authorities and the treatment of new supply. For the immediate future, however, we have to decide what guideline rent levels are set for 2008-09 and 2009-10. The expectation has been that we would return to the basic rent restructuring formula that would achieve convergence by 2012.
- 2.1.7 To achieve restructured rents by 2012 local authorities will have had to set their actual rents broadly in line with rent restructuring policy. Work done by the Department in the last two years indicates that a majority of local authorities now have actual rents that are above, on or only very marginally lower than guideline levels and therefore many of these authorities may not need to increase actual rents by as much as guideline rents would increase – therefore avoiding steep rent rises themselves. Others, whose actual rents are below guideline levels, have not in general increased their rent in line with increases implied by guideline rents.
- 2.1.8 As a result, we are minded to return to using the “caps and limits” formula that existed up to 2006-07 in the setting of guideline rents for 2008-09 and 2009-10 with annual increases in guideline rents based on a trajectory that would achieve convergence by 2012.
- 2.1.9 The Department is mindful that there are some authorities that may consider that a return to the 2006-07 guideline rent-setting formula could lead to higher rent rises for tenants.
- 2.1.10 This is why we are consulting on two options for determining guideline rents in the HRA subsidy regime for 2008-09 and 2009-10. The first is a return to rent restructuring with convergence in 2012. The second is to modify this approach by extending the convergence deadline and hence lower annual guideline rent increases. However, extending the deadline would have a cost impact which Government would have to consider when making decisions on the optimal allocation of limited available resources.
- 2.1.11 Both options have an element of protection against unaffordable annual rent increases. The loss of income for local authorities that results from the application of this protection is taken account of through an adjustment to the guideline rent in the year following that loss of income – not in-year as happened with the RCA.

3 Options for 2008-09 and 2009-10

3.1 Return to Basic Rent Restructuring with “caps and limits”

3.1.1 The first option is to return to the pre-existing rent restructuring policy aimed at rent convergence between the local authority and registered social landlord sectors by 2011-12, constraining individual actual rent increases through the use of “caps and limits”.

3.1.2 The formula for calculating Guideline rents would remain substantially as now:

$$2008-09 \text{ Guideline Rent} = [2007-08 \text{ Guideline Rent} \times (1 + \text{RPI} + \frac{1}{2}\%)]$$

plus

$$\frac{(2008-09 \text{ Formula Rent} - 2007-08 \text{ Guideline Rent} \times (1 + \text{RPI} + \frac{1}{2}\%))}{n}$$

where *n* is equal to 4 with a convergence date of 2011-12

3.1.3 The measure of inflation used to uprate rents is the Retail Price Index (RPI). This is because RPI is the measure of inflation most often considered when setting wages, and hence is the measure most closely related to what the tenant can afford to pay.

3.1.4 “Caps and limits” constraints protect against unaffordable rent rises and have two elements; a) caps on the upper values of actual rents and b) limits on the annual change of individual actual rents. “Caps and limits” was the method used for constraining annual rent increases before the introduction of 5% limit and the RCA.

3.1.5 “Caps and limits” are based on the assumption that rents should be increasing in line with the rent restructuring formula. They deliver restructured rents and moderate the impact of that formula to keep rents affordable.

3.1.6 The loss of income for local authorities that results from the application of “caps and limits” is offset through an adjustment to their guideline rent (which is one of the elements that determines entitlement to HRA Subsidy) in the following year.

3.1.7 Under the “caps and limits” system, the 2008-09 individual rent charged on a property should not exceed:

$$2007-08 \text{ rent} \times (1 + \text{RPI} + \frac{1}{2}\%) + \pounds 2$$

That is to say, year on year rental increases should be limited to half a percentage point above retail price inflation plus an extra two pounds. It should be emphasised that this provides a suggested maximum increase

for individual rents; it is not a target to be aimed for. This limit should be applied even where it means that an actual rent will not be fully restructured by 2011-12.

- 3.1.8 The 2008-09 limits are based on a projected RPI of 3.8%, therefore, the 2008-09 individual rent charged on a property should not exceed

$$(2007-08 \text{ rent} \times 1.043) + \text{£}2$$

- 3.1.9 In some cases the steep convergence for actual rents suggests that a strict application of rent restructuring policy will militate against affordability issues for some tenants. This is the situation that led to the introduction for a limited period, of the RCA.
- 3.1.10 The “caps and limits” system was designed to keep rental increases affordable to tenants and to offset any lost income to local authorities. Whilst this worked during the early stages of the rent restructuring process, we have identified a potential problem because of the way the “caps and limits” system operates. Because “caps and limits” adjustments on the Guideline rent can be up or down depending upon individual authorities’ circumstances there is a danger that it could perversely cause Guideline rents to rise at a faster rate than they otherwise would have.
- 3.1.11 To counter this effect, Communities and Local Government would propose to modify the way Guideline rents are adjusted in future. It is proposed that a “caps and limits” adjustment will only be made in the event that unconstrained rents are higher than constrained rents. In other words, no upward adjustments will be made to Guideline rents as a consequence of “caps and limits”. Where the adjustment would previously have suggested this, the adjustment will now be set to zero (a fuller explanation of this process is given at 3.2.6 and 3.2.7 below).
- 3.1.12 The effect of guideline rents being adjusted downwards will be to lower the trajectory of guideline rent, which may delay rent convergence beyond 2012 in some instances.
- 3.1.13 One disadvantage of this approach is that it will not always be possible for officials at Communities and Local Government to observe what rent rises would be implemented locally until after the calculation has been made.

3.2 Extended Rent Restructuring

- 3.2.1 The second option is a variation of the pre-existing rent restructuring policy, also using “caps and limits”, but with a rent convergence later than 2011-12.
- 3.2.2 The basic rent restructuring formula would remain the same, but the extended convergence period would allow for a shallower convergence trajectory, allowing local authorities to set lower annual rent increases without adversely affecting their resources.

3.2.3 The formula for calculating Guideline rents would remain substantially as now, but with a modified convergence date:

$$\begin{aligned}
 &2008-09 \text{ Guideline Rent} = [2007-08 \text{ Guideline Rent} \times (1 + \text{RPI} + \frac{1}{2}\%)] \\
 &\quad \text{plus} \\
 &\quad \frac{(2008-09 \text{ Formula Rent} - 2007-08 \text{ Guideline Rent} \times (1 + \text{RPI} + \frac{1}{2}\%))}{n}
 \end{aligned}$$

where *n* is equal to 4 plus the number of years convergence is extended past 2011-12.

3.2.4 The effect of extending the convergence date beyond 2011-12 is to increase the divisor in the formula, reducing the annual uplift accordingly. This allows the landlord to set annual rent increases at a lower level than would otherwise be needed to raise the rental income assumed by the HRA subsidy system.

3.2.5 If convergence is extended significantly past 2011-12 this would have two effects:

- First, only a few local authorities are likely to be in the position where they breach the “caps and limits” constraint.
- Second, if the pre 2006-07 system of “caps and limits” adjustments to Guideline rent is restored in its existing form, a majority of local authorities may find that their Guideline rent is adjusted upwards in 2009-10 as a result of the way in which “caps and limits” conventionally operates.

3.2.6 The “caps and limits” system has worked in the past as series of continual adjustments, one year in arrears, of guideline rents. It is calculated as follows:

$$\begin{aligned}
 &\text{“caps \& limits” adjustment} = \\
 &\text{constrained guideline rent } \textit{minus} \text{ unconstrained guideline rent}
 \end{aligned}$$

3.2.7 Where the constrained rent is greater than the unconstrained rent, the adjustment leads to an additional increase in the following year’s guideline rent. Conversely, where the unconstrained rent is greater, the adjustment reduces the guideline rent.

3.2.8 As with the option outlined in section 3.1, Communities and Local Government would propose to modify the way Guideline rents are adjusted in future. It is proposed that a “caps and limits” adjustment will only be made in the event that unconstrained rents are higher than constrained rents. Otherwise this adjustment will be zero.

4 Issues for Consultation

4.1 Scope of Consultation

- 4.1.1 Comments would be welcome on any and all aspects of the proposals in this consultation paper. It would, however, be helpful if those responding to this consultation paper could structure their responses around these proposals.
- 4.1.2 Comments are invited on how we propose to set guideline rents in the 2008-09 and 2009-10 HRA subsidy determinations. In particular local authorities are asked to consider the effect not just upon their HRA subsidy entitlement and the effect it will have on actual rent increases, but on the amount of resource that will be available to the authority within its HRA.
- 4.1.3 Respondents are reminded that the thrust of the policy discussions is toward continued affordability in local authority rents for tenants. Comments on wider aspects of rent and subsidy policy are not at this stage, being solicited.
- 4.1.4 No decisions have yet been taken on what changes, if any should be made to the short term application of rent policy from 1 April 2008. Communities and Local Government is interested in stakeholders' views on all aspects of the options outlined in this consultation paper and a final decision will be taken in time for the draft HRA Subsidy Determination exercise in October 2007, which will itself be subject to the usual consultation.

4.2 Summary of Options

- 4.2.1 There are two practical options for the immediate future of rent policy over the next two financial years; it may be that there are others.
- 4.2.2 Comments from stakeholders are welcome particularly on the following possibilities which have been discussed in detail in Chapter three above:
- A return to the basic rent restructuring formula with “caps and limits” – particularly with regard to the relationship with RPI;
 - Extending rent restructuring by a set number of years to reduce the steepness in the trajectory of guideline and therefore actual rent rises.

4.3 How long do I have to comment?

- 4.3.1 The deadline for comments is **4 October 2007**. It would be helpful if responses were sent to us as soon as they are ready, rather than waiting until the closing date. Responses should be sent before the due date to:

Victoria Akeredolu
Department for Communities and Local Government,
Eland House,
Bressenden Place,
London SW1E 5DU

Telephone number: 020 7944 3602
Email: housing.subsidy@communities.gsi.gov.uk

Further copies of the paper can be obtained from the above address.
This Consultation Paper is also on the Department's web site at
<http://www.communities.gov.uk>

4.4 Will my comments be made public?

- 4.4.1 Unless you indicate that you wish your comments to be treated as confidential, we will assume that you are content for a copy to be made publicly available in the Department's Libraries and the House of Commons Library. All responses will be included in statistical summaries of comments received and views expressed.

4.5 Organisations to which this Consultation Paper has been sent

- 4.5.1 This consultation paper has been sent to all housing authorities in England and to the major bodies with an interest in housing matters. Copies will also have been downloaded from the Department's web site.

- 4.5.2 Complaints about the consultation process should be sent to:

Albert Joyce,
Communities and Local Government Consultation Co-ordinator
Zone 6/H10, Eland House, Bressenden Place, London SW1E 5DU;
or by email to:
albert.joyce@communities.gsi.gov.uk

Please note that responses to the consultation itself should be sent to the contact shown within the main body of the consultation.