Chartered Institute of Housing

Rent consultation analysis

FINAL REPORT 18 December 2024

1.1 Introduction - contents

- Government Consultation on future social housing rent policy issued 30.10.24
  - *https://www.gov.uk/government/consultations/consultation-on-future-social-housing-rent-policy/future-social-housing-rent-policy*
  - Closing date 23.12.24
- Key proposals:
  - Establish an approach to a longer-term rent settlement across multiple years to deliver stability and predictability – initially for 5 years beginning 2026.27, potential for a rolling 5-year rent setting horizon from 2027.28, or settlement for a further period – up to 10 years
  - Allow social rent increases up to CPI+1%
  - Views sought on stability, length of settlement, rate of increase, and any other measures in relation to rents that would help housing providers deliver on asset management and ambitions for new supply
  - Views also sought on affordability and any other non-rent measures that would assist providers

- Analysis and research undertaken for the Chartered Institute of Housing working in partnership with the NHF, LGA, NHC, ARCH, NFA and CWAG
- Covering the following key overall areas

1. Projected impact of CPI+1% for local authorities (LAs) and housing associations (HAs) over 5 years and 10 years – taking into account the additional costs to LAs and HAs arising from the changes to Employers National Insurance payment rates from 2025.26
2. Potential for a stable CPI+1% rent policy to encourage greater investment from providers
3. Projected impact of convergence to formula rents was able to be introduced - modelled separately for HAs and LAs, undertaken at £2 per week and £3 week as examples
4. For local authority Housing Revenue Accounts (HRAs) specifically, an assessment of the implications for HRA debt
5. For housing associations specifically, analyse via conversion into capacity for investment using interest cover ratio as key metric
6. A high-level assessment on affordability for tenants

2.1 Technical inputs

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- We have established national forecasting models for the housing association sector and the local authority (HRA) sector
  - The HA model excludes For Profit RPs
- The models are controlled to previous work undertaken by Savills in 2024
  - Work undertaken for LGA/ARCH/NFA published October 2024
  - Work undertaken for the National Housing Federation (unpublished)
- The control models exclude
  - Impact of additional NI costs and September CPI being 1.7% (previously forecast to be 2.5%)
  - For local authorities lower Right to Buy sales (expected now as a result of the recent announcement on the restriction of discounts)
  - Rent increases assumed at CPI-only from 2026
- Core data sources
  - LADR 2023.24 and SDR 2023.24
  - Global accounts 2022.23 with published summary insight into 2023.24 (yet to be formally published)
  - Savills HRA accounts analysis

Key assumptions applying to both HA and LA projections

- CPI rates
  - September 2024 – 1.7% driving rent increases 2025.26
  - September 2025 – 2.7% driving rent increases 2026.27
  - September 2026 – 2.3% driving rent increases 2027.28
  - September 2027 – 2.1% driving rent increases 2028.29 then all years CPI at 2.0%
- Interest rates reduce in line with Bank of England forecasts
- Employers NI costs added all years: 2.25% on 65% of management and 15-20% of repairs (assumed that service costs recoverable from service charges)

Key assumptions applying to HA sector specifically

- Property additions as per an assumed reduction from totals in 2023.24
- Grants rates weighted £132k (social rent) / £82k (affordable rent) / £62k (shared ownership) (ratio broadly 20:40:40); delivery of 80% social rent for future new build
- Asset investment £40,000 p/u over 30 years (alternative at £50k p/u also modelled); with one of the scenarios for HAs being the availability of grant to help finance investment in the existing stock; a further scenario relating to affordable debt guarantees
- Capacity to invest in additional new homes whilst interest cover recovers to 150%

Key assumptions applying to LA sector specifically

- RTB sales 0.42% pa to 2025.26 then 0.11% pa all years
- Asset investment £62,000 p/u over 30 years – with significant additional borrowing implied up-front to address backlogs

2.2 Rent modelling scenarios

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For each sector… scenarios run as follows:

1. Baseline projection
   - CPI+1% rent increase to 2025.26
   - NI additions
   - Property additions (HAs) and reduction (LAs) per core inputs
   - For both sectors, the baseline projection has deteriorated against the control scenario, primarily as a result of the NI/lower CPI drivers
2. Revised baseline projection CPI+1% for 5 years
3. Revised baseline projection CPI+1% for 10 years
4. Convergence at £2/week on top of CPI+1% for 10 years including relet convergence
5. Convergence at £3/week on top of CPI+1% for 10 years including relet convergence

Outputs: estimates of…

- The trajectory of average rents for each sector under each of the scenarios
- Additional rent income able to be raised cumulatively through the scenarios
- Impact on the financial viability of each sector arising from the addition of rent income via the scenarios
- For HAs, this is expressed at projected sector interest cover – driving potential additional capacity – "converted" into capacity for additional delivery
- For LAs, this is expressed as a projection of the "national HRA" – with each successive scenario adding resources into the projection to generate surpluses - which can be "converted" into capacity for additional delivery

Additional technical notes on rent convergence scenarios

- £2 was the historic approach to convergence from the introduction of the rent formula in 2000 to suspension of convergence in 2016; £3 tests the extra income derived by going "faster"
- No tolerances have been assumed to be added to general needs homes in our scenarios – it is recognised that many housing associations and some local authorities add up to an additional 5% tolerance on reletting on properties; however, the addition of tolerances risks distorting the analysis around CPI, CPI+1% and convergence, as providers take their own decisions, and practices vary
- It should be noted that 100% accuracy for convergence projections can only be achieved at the individual property level – however the granularity of forecasts at HA by LA and LA by LA level for property sizes (bedsit to 6+ beds) level reduces error-spread to a minimum

3.1 Average rent forecasts – local authorities

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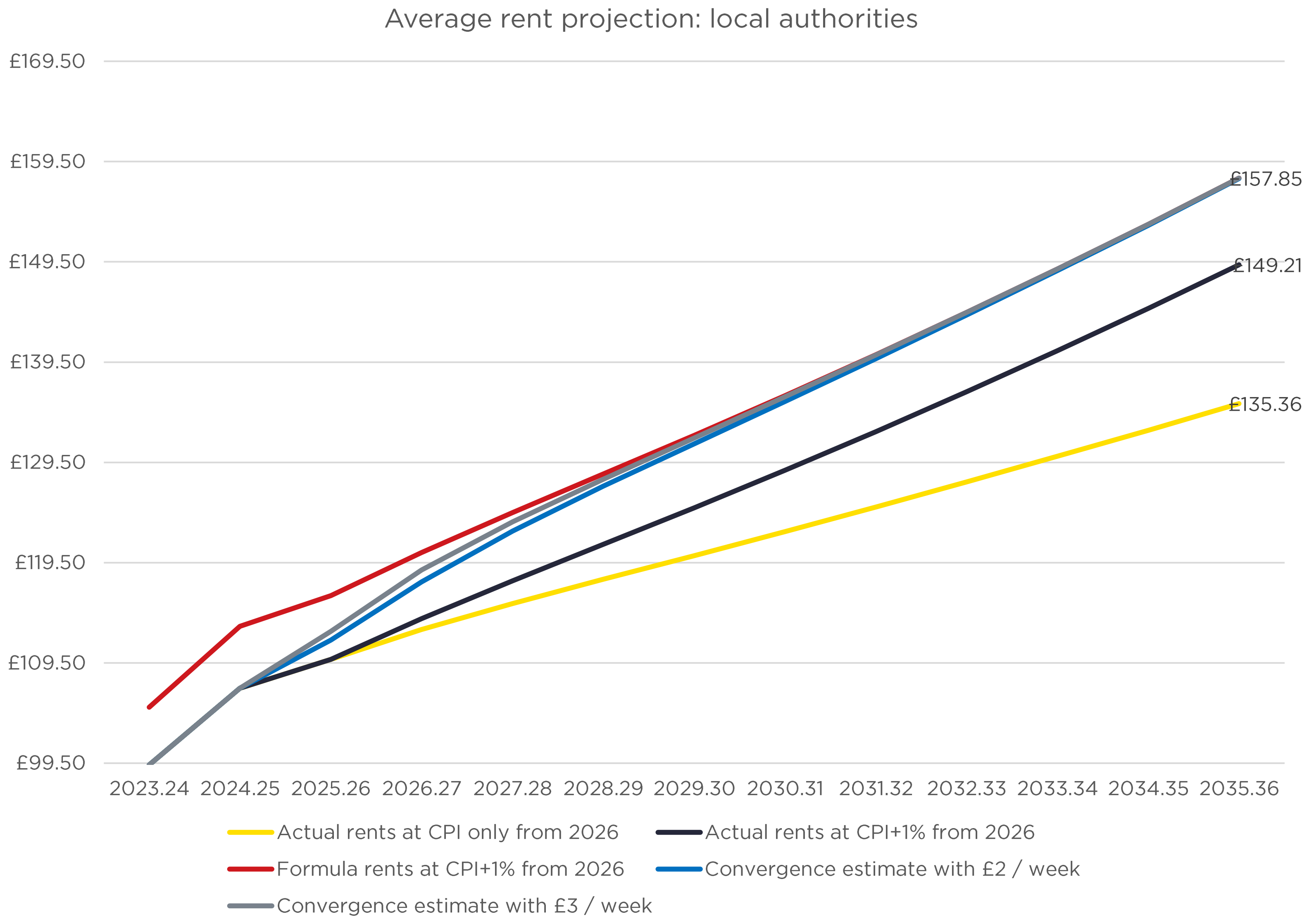
Headlines

- Average rent in 2023.24 was £99.32
- Average formula rent in 2023.24 was £105.06
- Average "gap" between actual and formula rent was £5.74 or 5.47%
- CPI+1% for rents over 10 years with no convergence would result in average rents of £149.21 compared to £135.36 for CPI only increases
- Average formula rents increasing with CPI+1% would be £157.85 by 2035.36
- Rent increases at CPI+1%+£3/week would result in convergence with average formula rents in 2032.33
- Rent increases at CPI+1%+£2/week would result in rents within 5p/week of convergence with average formula rents by 2035.36

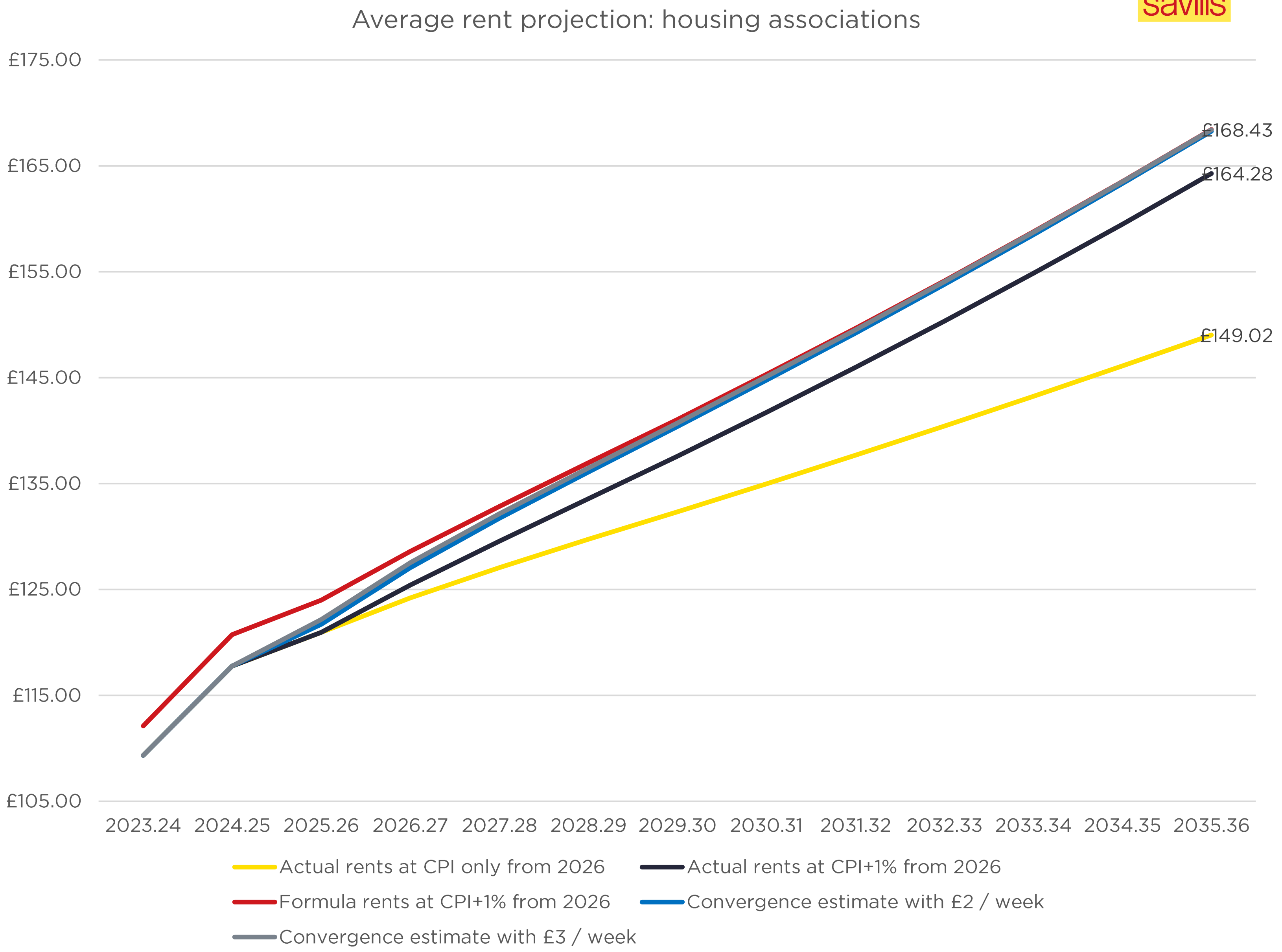


LA RENT CONVERGENCE

3.2 Average rent forecasts – housing associations

Headlines

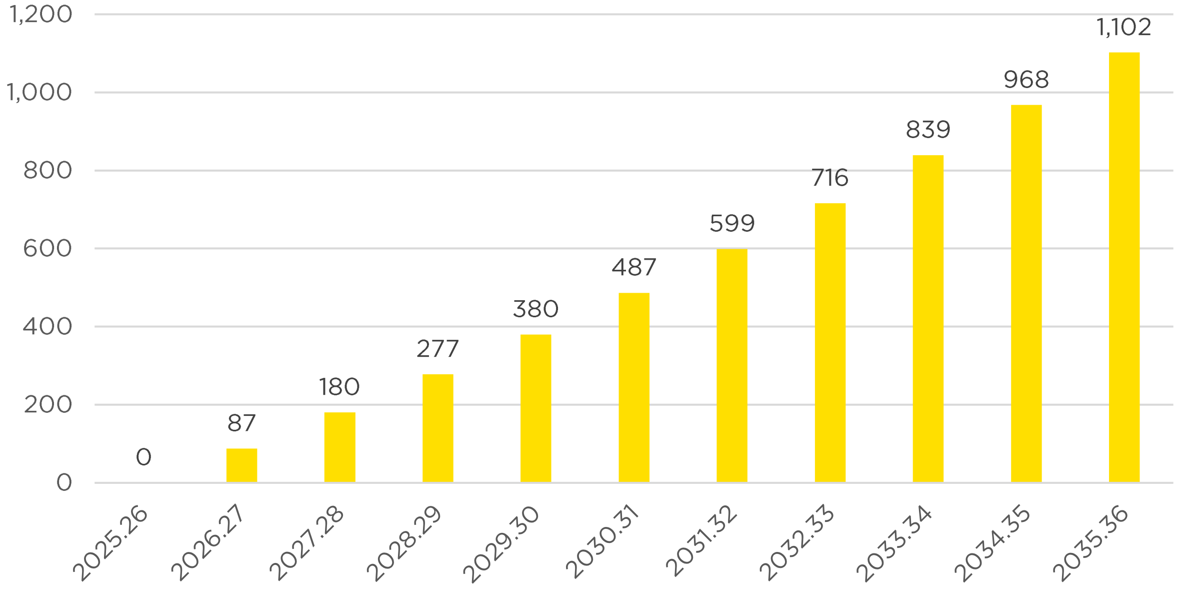
- Average rent in 2023.24 was £109.34
- Average formula rent in 2023.24 was £112.11 (excluding tolerances)
- The average "gap" between actual and formula rent was £3.76 or 2.47%
- CPI+1% for rents over 10 years with no convergence would results in average rents of £164.28 compared to £149.02 for CPI only increases
- Average formula rents increasing with CPI+1% would be £168.43 by 2035.36
- Rent increases at CPI+1%+£3/week would result in rents within 2p/week of convergence with average formula rents by 2035.36
- Rent increases at CPI+1%+£2/week would result in rents within 16p/week



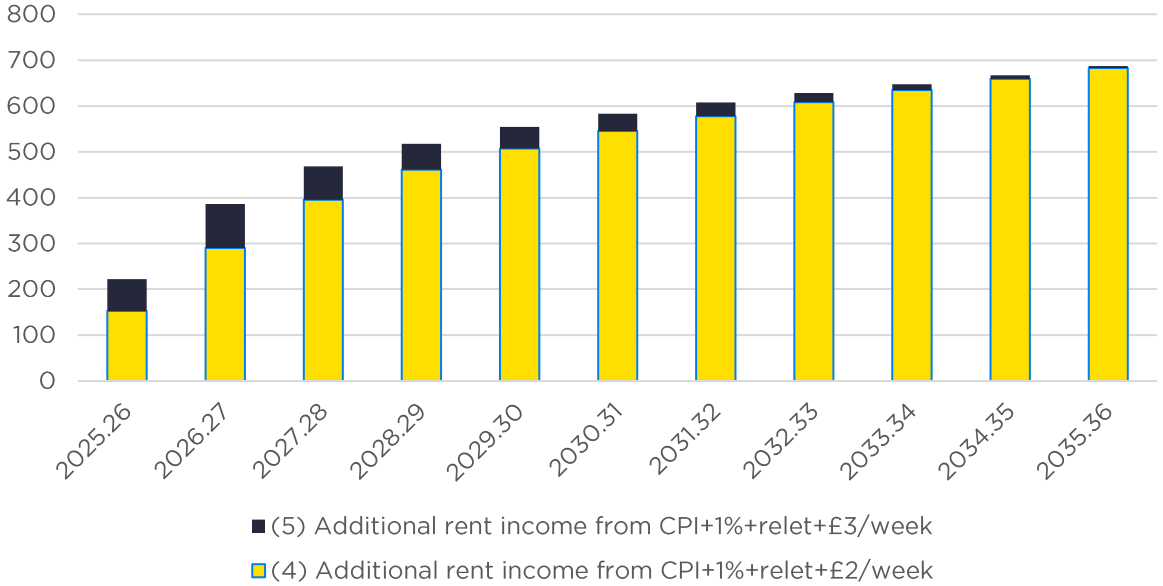
HA RENT CONVERGENCE

3.3 Additional rent income – local authorities

Additional rent income from CPI+1% increases £m LAs



Convergence scenarios LAs



Headlines for rent increases at CPI+1%

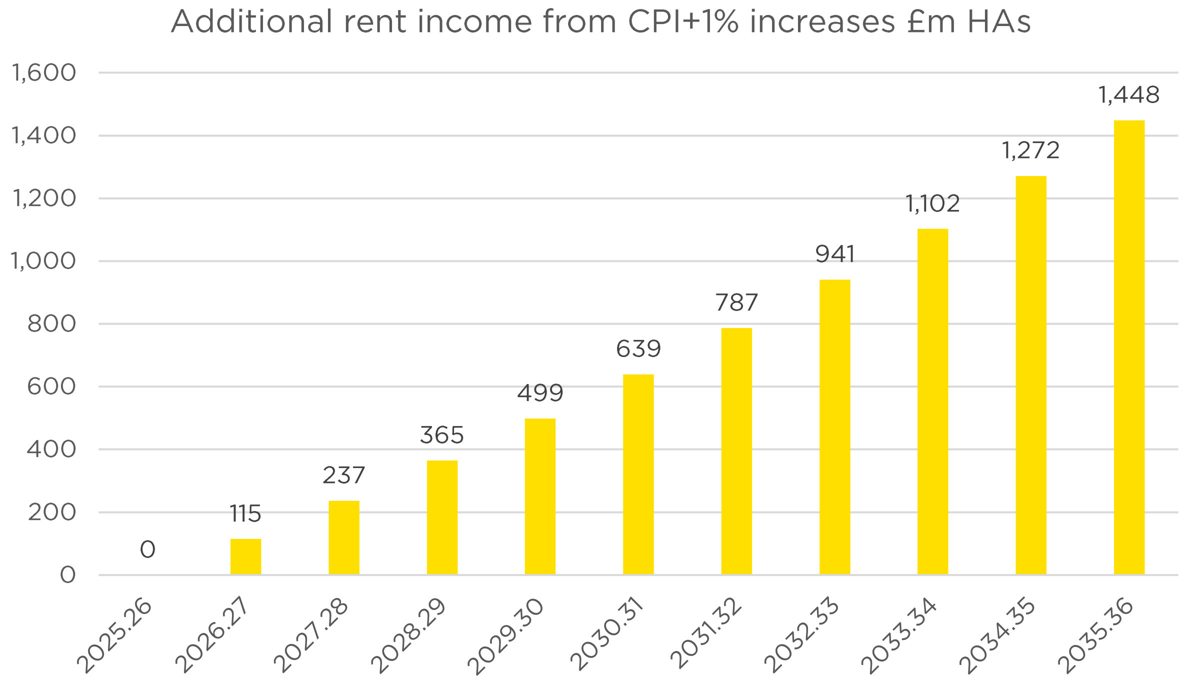
- Cumulative annual in-year impact of CPI+1% increases (compared to CPI only) increases = £1.1bn per year by 2035.36 – the impact of which would continue all years beyond 2036; this totals cumulative additional income in 10 years = £5.6billion or an estimated cumulative £31billion over a 30-year business planning period
- For CPI+1% for 5 years, the impact is much reduced to £0.48bn per year by 2030.31, cumulatively £16billion over 30 years

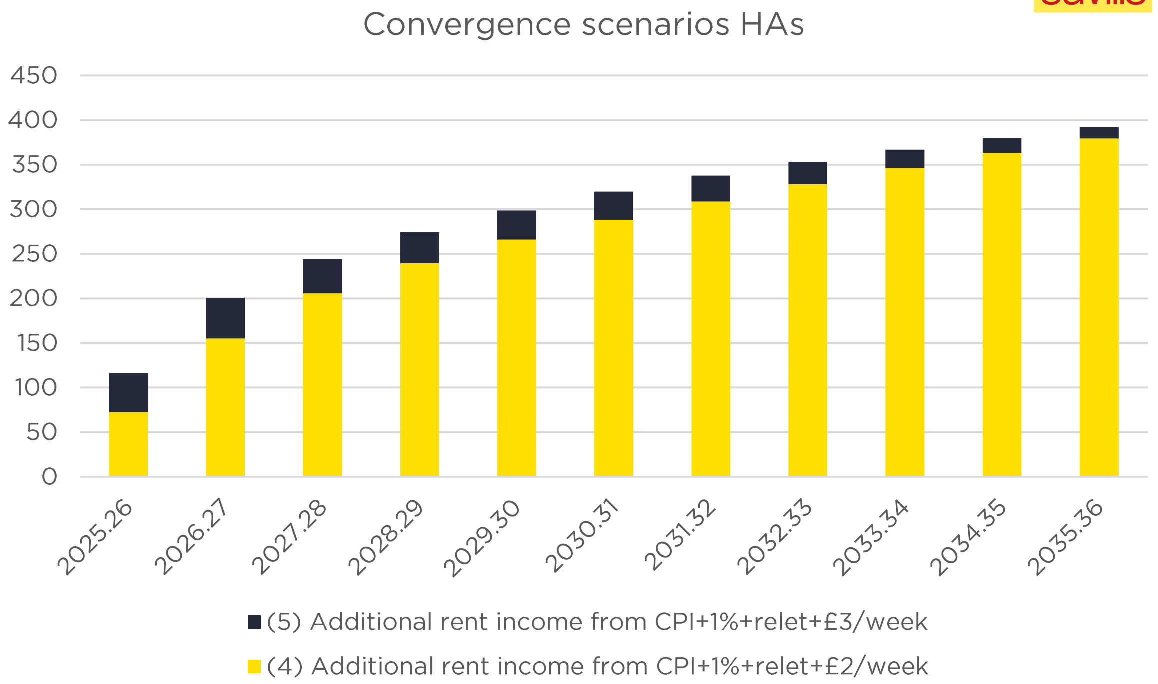
Additional rent income from convergence scenarios	£2 / week convergence	£3/ week convergence
In year impact by 2035.36	£674m	£685m
Cumulative additional rent income 10 years	£5,516m	£5,970m

Headlines for convergence

- The total additional rent income over 10 years from convergence including relet at formula rent and weekly additional convergence factor on top of CPI+1% at:
  - £2/week: £5.516billion
  - £3/week: £5.970billion
- For reference, the additional rent income from reletting at formula rent at CPI-only rent increases would be c£2billion

3.4 Additional rent income – housing associations





Headlines for rent increases at CPI+1%

- Cumulative annual in-year impact of CPI+1% increases (compared to CPI only) increases = £1.4bn per year by 2035.36 – the impact of which would continue all years beyond 2036; this totals cumulative additional income in 10 years = £7.4billion or an estimated cumulative £41billion over a 30-year business planning period
- For CPI+1% for 5 years, the impact is much reduced to £0.64bn per year by 2030.31, cumulatively £21billion over 30 years

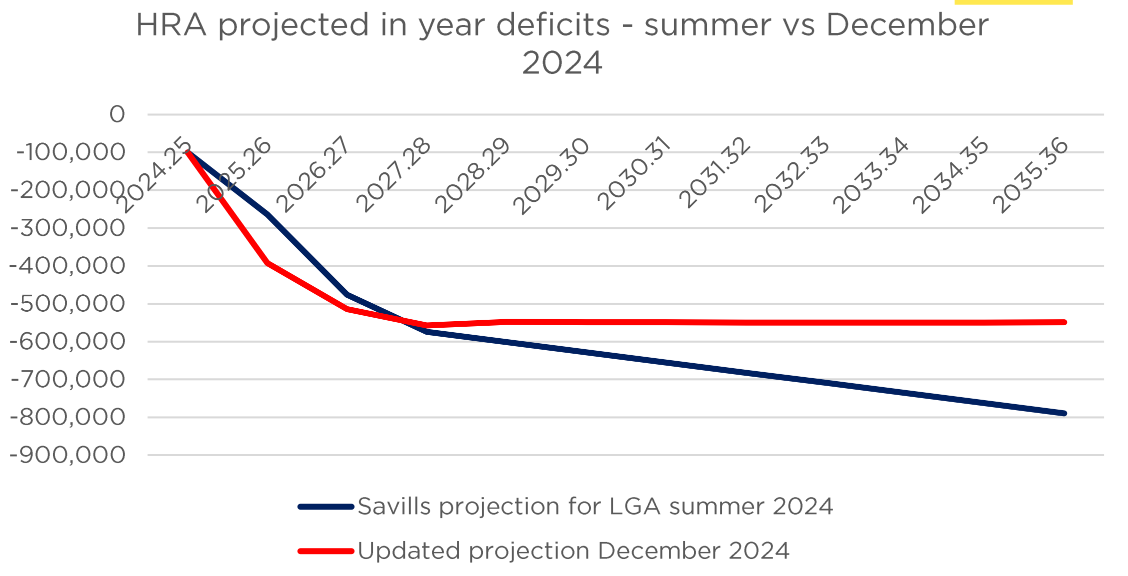
Additional rent income from convergence scenarios	£2 / week convergence	£3/ week convergence
In year impact by 2035.36	£379m	£392m
Cumulative additional rent income 10 years	£2,953m	£3,284m

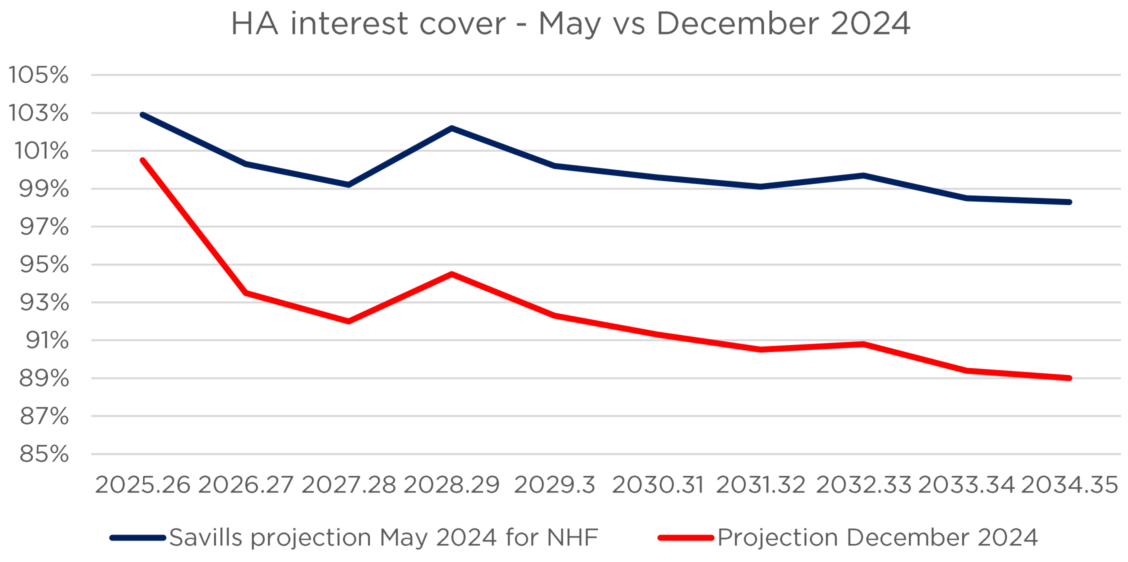
Headlines for convergence

- The total additional rent income over 10 years from convergence including relet at formula rent and weekly additional convergence factor on top of CPI+1% at:
  - £2/week: £2.953billion
  - £3/week: £3.284billion
- For reference, the additional rent income from reletting at formula rent at CPI-only rent increases would be c£1.1billion

3.5 National projection: basis for baseline projection

- Income projections arising from changes to rent policy are only one side of the picture
- In order to understand the implications for capacity and delivery from rent policy scenarios, need to understand expenditure pressures – these have intensified during the course of 2024
- A proportion, potentially a large proportion, of any additional rent income will be required to address these additional expenditure pressures
- Implications of baseline projections (scenario 1) against control scenarios from projections made earlier this year; implications of:
    - NI changes: added 2.25% applying to 65% of management costs and 15-20% of maintenance costs, with impact on service chargeable costs assumed recoverable
    - Impact across the stock estimated at c£34/unit for LAs and £36/unit for HAs
    - Lower September 2024 inflation reduces 2025.26 rent income by c£65m for LAs and c£105m for HAs
    - Inflation and additional demand applying to repairs / Awaab's Law pressures (damp, mould, litigation, general demand)
    - Inflation in capital costs from rising unit rates and progression of stock surveys highlighting challenges with condition
    - Both result in costs rising well above CPI for repairs and capital, for LAs this is significantly above 10% and for HAs BCIS assumptions are increased by 0.45%
    - For LAs, lower RTB sales volumes result in retention of more net income over the long term
- The HRA forecast is worse in the early period (NI/costs) but improves within a few years as a result of many fewer RTBs
- HA interest cover forecast is also worse due to NI and cost pressures





3.6 National projection: local authority HRAs

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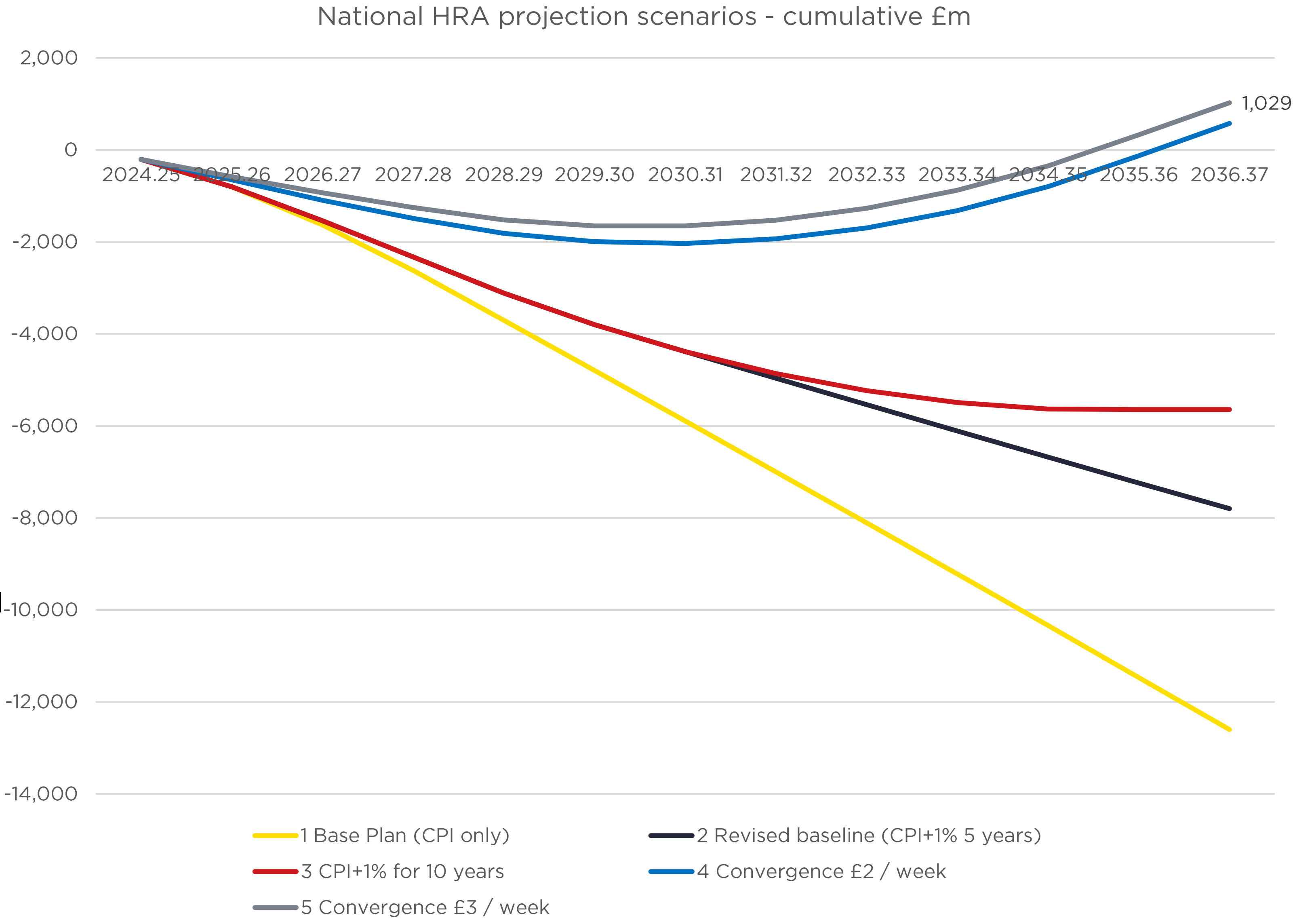
Key headlines

- At CPI only rent increases, cumulative HRA deficits are over £12billion by 2036.37
- CPI+1% for 5 years improves to a cumulative deficit just below £8billion
- CPI+1% for 10 years stabilises net rent income by 2036.37
- Rent convergence at either £2 or £3 week delivers cumulative surpluses of up to £1.0billion by 2036.37
- Potentially enables all existing stock pressures to be addressed with some capacity for additional development
- BUT this does only take effect from 2034 – implying that deficits will need to be addressed by resources other than rent policy in the medium-term
- Additional resource injection implied to cover immediate and short-term pressures and to unlock development capacity



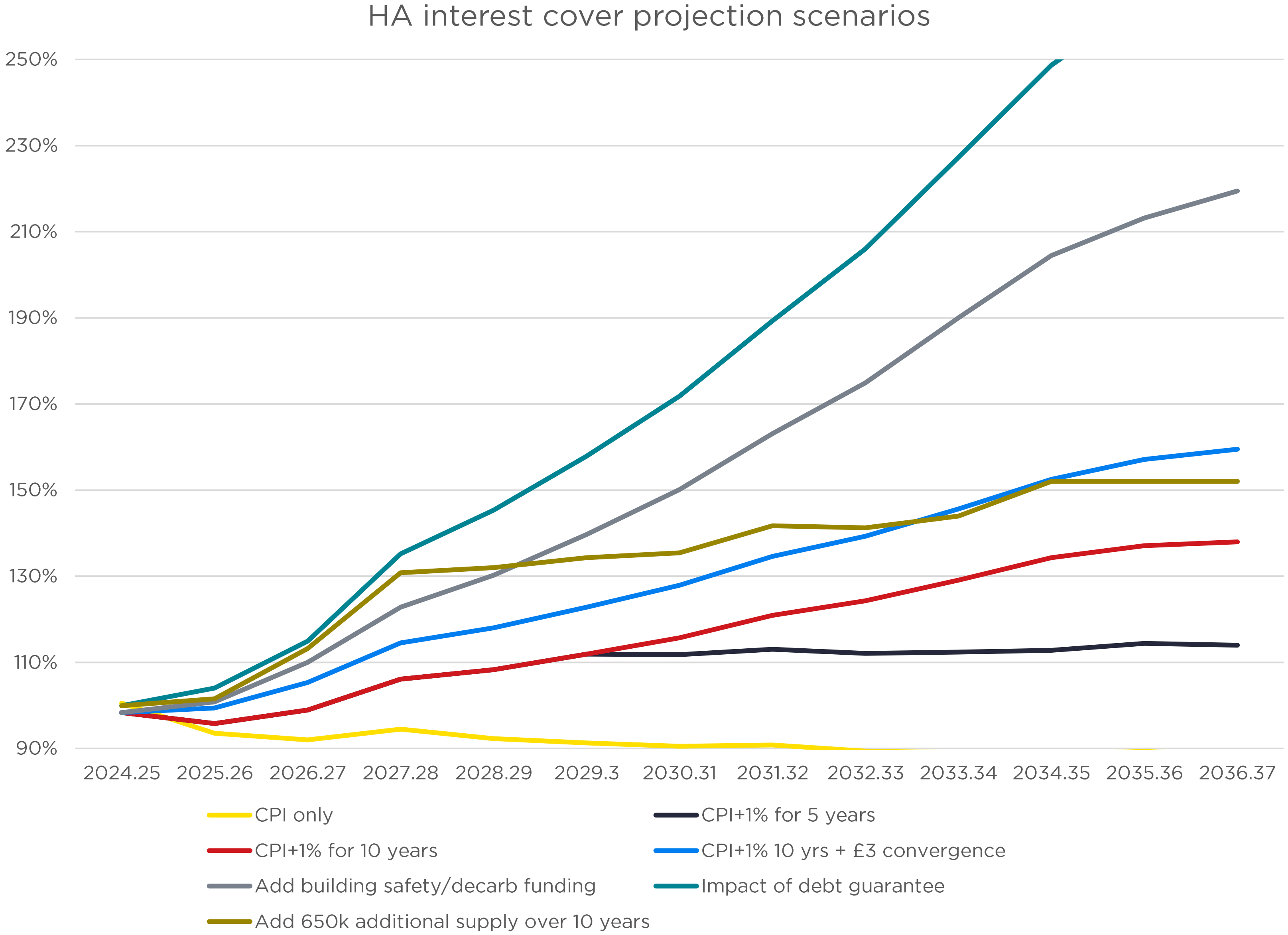
LA SECTOR PROJECTION

3.7 National projection: housing association sector

savills

Key headlines

- At CPI only rent increases, interest cover declines to below 90% for the medium term
- CPI+1% for 5 years improves cover to 114% by 2036.37
- CPI+1% for 10 years improves cover to 137% by 2036.37
- Rent convergence at £3 / week delivers cover around 157% by 2036.37
- Additional non-rent scenarios…
  - Scenario with building safety/decarb funding at £2bn pa lifts projected interest cover to above 210% - highlighting how funding for existing stock pressures can inlock capacity for new supply
  - Adding the impact of extending affordable housing debt guarantees lifts capacity further
- Final scenario shows how new supply can be increased by 650,000 and sector interest cover lifted to the long term norm of above 150%



HA SECTOR PROJECTION

3.8 Capacity conversion

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For local authorities

- The principal benefit of a rent increase policy of CPI+1% would be towards stabilisation of HRA finances into the medium term
- Additional annual rent of £487m by the fifth year of a CPI+1% policy would assist in helping reduce annual deficits but not eliminate them
- Additional annual rent of £1.1bn by the tenth year of a CPI+1% policy would return the annual HRA position to surplus
- Only a package around full rent convergence in addition to CPI+1% increases would return the national HRA to cumulative surplus in 10 years – by delivering an annual addition to rent income of £687m in the tenth year (based on £3/week)
- If all of the additional rent income from convergence were committed in total to borrowing for development / acquisition, this might suggest c£10-12bn of additional borrowing capacity
- Based on £250k delivery cost and 50% average grant for HRA social rent, this might suggest capacity for up to 80,000 additional homes – however…
- In practice, authorities are likely to commit additional rent income to existing stock pressures in order to return to HRA surplus – beyond 2034, capacity for investment rises rapidly and could allow the delivery of an additional 30,000 homes from that date

Additional capacity for new homes in 10 years	HAs	HRAs	HA top up required to IC 1.10	HRA deficit funding to address
1 Base plan – CPI only	-	-	c£2.bn	£12bn
2 CPI+1% for 5 years	-	-	-	£8bn
3 CPI+1% for 10 years	-	-	-	£6bn
4 Convergence at £3/week	-	Up to 30 k	-	£3bn
5 Decarb/B Safety £2bn pa	-	-	-	n/a
6 Debt guarantees	650 k	-	-	n/a

For housing associations

- The principal benefit of a rent increase policy of CPI+1% would be towards stabilisation of HA finances into the medium term
- CPI+1% for 5 years would help stabilise interest cover to main funder covenants with little or no additional capacity for investment
- As a minimum, only CPI+1% for 10 years returns the HA sector cover to above funder covenants
- A package around full rent convergence allows a meaningful increase in investment capacity over a 10-year period; however in order to change the dial significantly, support for investment into the existing stock and the extension of debt guarantees offer a material way to increase new supply
- Based on the delivery of a balance of 80% social rent and 20% other tenures, at £260k delivery cost and a contribution from s106 schemes equivalent to the balance in 2023.24, an estimated 650k additional new homes could be delivered from this full package of measures whilst lifting interest cover to 150%

The baseline projections are BOTH for significant early year ongoing pressures – HRA deficits and HA interest cover below 1.1

This implies a need for additional funding to address these pressures in order to allow existing stock and services to be maintained and delivered, though much greater pressure for HRAs

4.1 HRA debt settlement: implications of scenarios

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Impact on HRA debt settlement of various changes to rent policy £m	Rents CPI+1% all years from 2026	Rents at CPI-only from 2026	Rents CPI+1% for 5 years only from 2026	Rents CPI+1% for 10 years only from 2026	Rent convergence £3/week from 2025	Rent convergence £3/week CPI+1% for 10 years only
Original settlement	29,188					
Revision for authority numbers	-503					
Recast original settlement	28,685					
Revision for rent policy (rent cuts 2016-2020 and rent cap in 2023)	-10,184	-11,980	-10,970	-10,411	-8,638	-8,759
Revision for higher fire/building safety standards	-4,535					
Revision for capital repairs inflation which will not be reversed	-1,555					
Revision for enhanced regulatory pressures	-0.932					
Revision for reduced property numbers due to RTB discounts	-228					
Speculative consolidated revised settlement	11,251	9,455	10,465	11,024	12,797	12,676

Work undertaken for CIH in the spring of 2024 analysed the impact of a range of changes to government policy since the HRA self-financing settlement of 2012 on the amount of debt that HRAs can support.

The methodology adopted is based on revisiting the original settlement by applying various policy and other changes (outside of local authority control).

Much more work would need to be done at the local authority level, particularly for those issues relating to standards (where stock composition would be very different between different authorities), however the analysis provides an insight into the order of change required to get authorities back to the financing position they were in 2012.

For this exercise, we have applied the various options for the future of rent policy analysed elsewhere within this paper to the settlement revision. The key points are

- The original settlement envisaged rent increases at RPI+0.5% for 30 years (equivalent to CPI+1%) – the revision to £11.251bn therefore contains an assumption that rent increases would be CPI+1% in all years from 2025 onwards with no rent convergence
- If increases are CPI+1% for only 10 years – the settlement would reduce to **£11.024bn**
- If increases are CPI+1% for only 5 years – the settlement would reduce to £10.465n
- If increases revert to CPI-only all years from 2026, the settlement would reduce to £9.455bn
- Conversely, allowing rent convergence at £3/week would increase the debt sustainable by HRAs to £12.797bn with CPI+1% for all years– and if CPI+1% was only allowed for 10 years, to **£12.676bn**

CIH paper on revision to the HRA settlement July 2024: *https://www.cih.org/media/ocljn5sc/0508-briefing-on-hra-report-v3.pdf*

5.1 Benefits of 10-year rent certainty

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- 10 years of certainty over rent policy would give HA boards and LA members more confidence to invest in bigger schemes, buy land more strategically, and invest in their supply chains and internal capacity. It may also lead to cheaper debt costs.
- All these provide the potential to deliver more new homes more efficiently, than two consecutive five-year settlements with the uncertainty halfway through of one ending and another being confirmed.
- One way of quantifying the benefit of a ten-year settlement is to look at how equity investment would be priced differently under the two scenarios (5 years and 10 years)
- Savills has worked with a range of investors and we have aimed to generate an estimate of the financial and investment premium that further predictability in rent policy might deliver
- The majority of stock acquired by investors has been newly developed (via s106 agreements or direct development with grant from Homes England and the GLA) and has been focused on shared ownership and affordable rent tenures; social rent is therefore a minority tenure for FPRPs (< 2,000 per the SDR 2024); this means that the issue around convergence back to formula rents is less of an issue for investors
- If rent policy is stabilised for 5 or 10 years or longer, the view of risk reduces, investment value increases and return requirements reduce
- The outputs quoted opposite should therefore be seen as a guide – the key positive from rent policy stabilisation would be around investor appetite and confidence

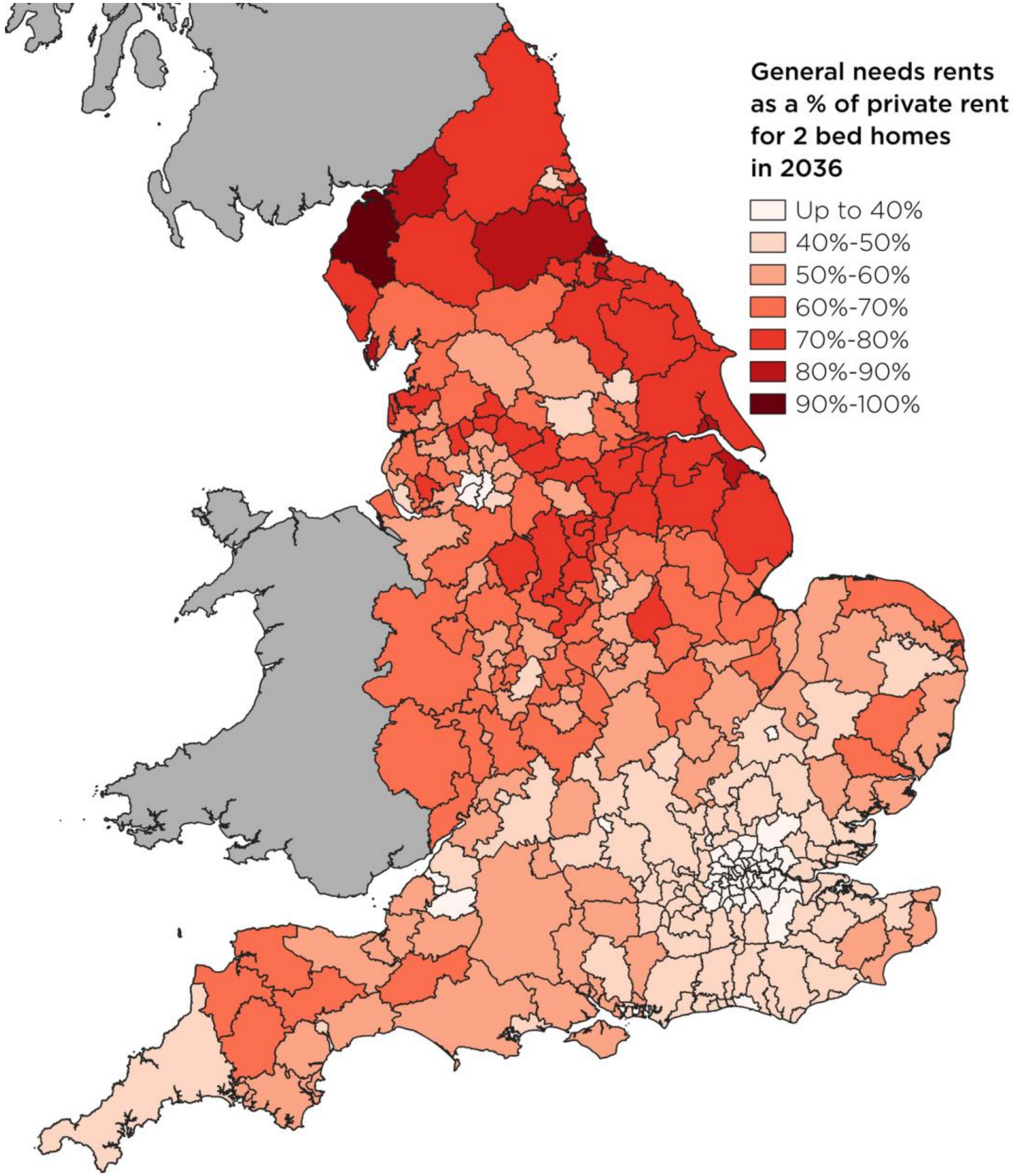
Rent stabilisation scenario	Value / yield enhancement	Properties in 10 years (CPI-only = 10,000 pa as an example)
CPI+1% for 5 years	0.24%	140,000
CPI+1% for 10 years	0.45%	188,000
CPI only	-	100,000

- Most investors will underwrite their investments on the basis that rents will increase at least CPI over the long-term – as this has been the pattern for many decades
- The additional value derived from CPI+1% for 5 years would be 0.24% off returns – if CPI only required 4% yields, this would reduce to 3.76% and increase in capacity of 6%
- The additional value derived from CPI+1% for 10 years would be 0.45% off returns – if CPI only required 4% yields, this would reduce to 3.55% and increase in capacity of over 11%
- Additional value for a 5-year rolling stabilisation policy remains at 0.24% as decisions are taken on the basis of the position each year
- 10-year settlement would deliver nearly double the additional value
- The table illustrates that if investors were to finance 100,000 new homes in 10 years with a CPI-only policy, a 5-year rolling settlement might allow this to increase to 140,000 but a 10-year settlement would increase capacity to 188,000

- The above is consistent with the White Paper produced by Legal & General and the British Property Federation Affordable Housing Committee in 2022; this analysis quoted that a stabilisation of rent policy at CPI+1% for 10 years would drive an additional c10% on value and therefore increase capacity for investment by 10%
- The paper can be found here… *https://group.legalandgeneral.com/en/newsroom/our-research/delivering-a-step-change-in-affordable-housing-supply*

6.1 Affordability: rents relative to the private sector

- Savills research into the relative affordability of social rents against market rents undertaken in the summer of 2024- *https://www.savills.co.uk/research_articles/229130/366421-0*
- Objective to show how the relative affordability of social rents might change as a result of the introduction of a social rent policy of CPI+1% increases for 10 years from 2026-2036
- Comparing social rents forecast over 10 years at CPI+1% increases against Savills forecast for market rents over the same period at the local authority level – for an exemplar 2-bed social rented housing association home utilising average rents at the LA level from the SDR 2024 (noting that equivalent LA rents are c7% below HA levels)
- The analysis shows that:
  - Social rents stay well below market rents in virtually all parts of the country
  - In London and the South East, CPI+1% rent increases for social rents maintain them below 50% for most LA areas
  - Only in a handful of authorities (those with an under-developed market rented sector), would social rents rise above 80% of market rents over a 10-year period
  - The results highlight that there should be confidence that a rent increase policy of CPI+1% will not fundamentally change the relative affordability of social rents compared to the private sector



6.2a Affordability: for tenants and residents

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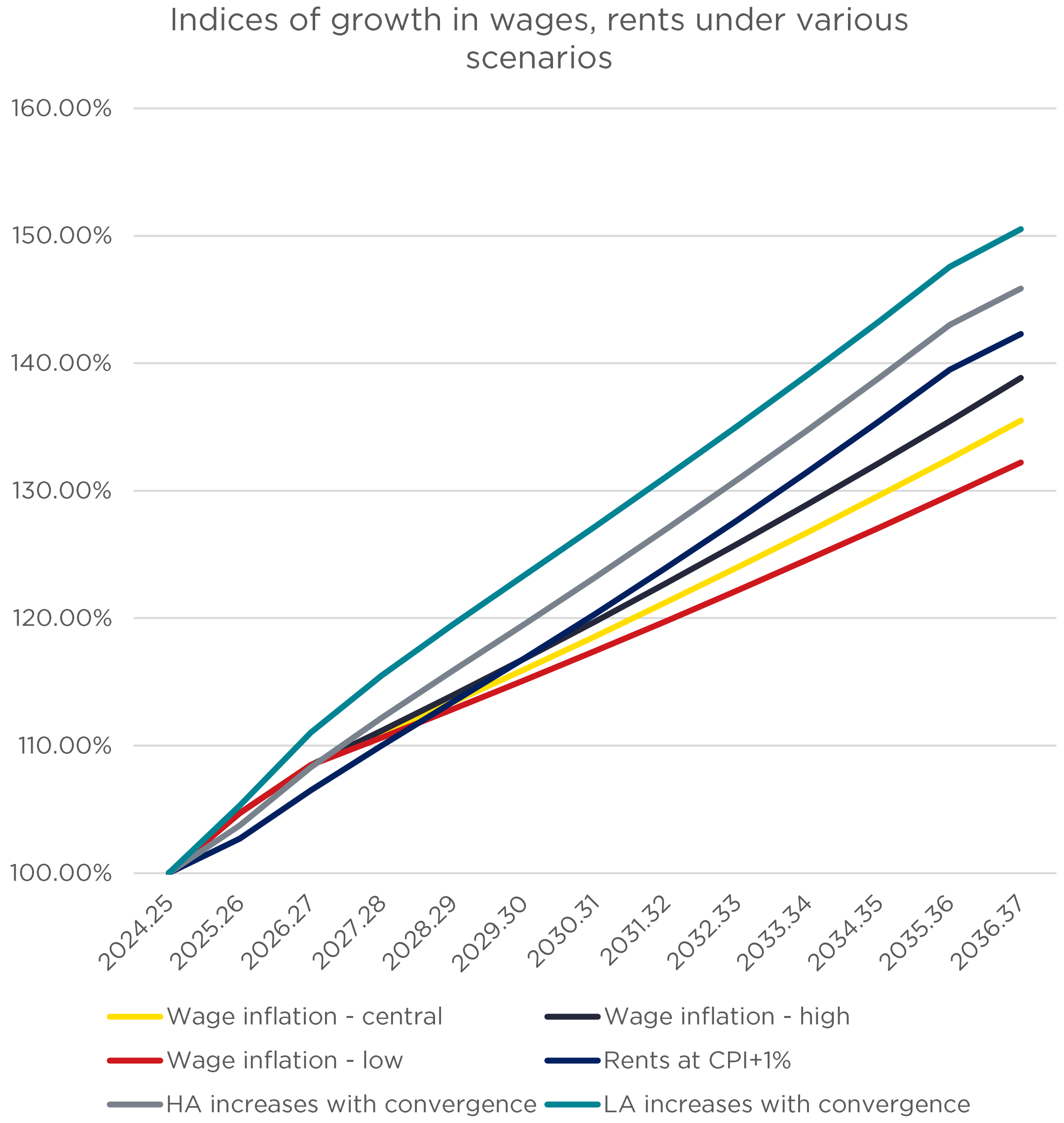
- Aim to make an assessment of the affordability of rents were they to increase at a faster rate than wages inflation and/or housing benefit/UC thresholds
- Also to make an assessment on the housing benefit costs of additional increases in rents
- Drawing upon material from CIH (re HB) and NHF (affordability scenarios for household typologies)
- Comparing potential future wage inflation projections with increases in average rents under convergence scenarios
- Converting differential growth in wages vs rents into average £/week household pressure
- Highlights how rent affordability might change if wage inflation diverges from CPI+1% over the medium term

- Using 2024.25 as the base year, chart highlights growth in rents for HAs and LAs using £3/week convergence on top of CPI+1% increases compared to growth in wages on three measures: central, low and high
- Central wages projection based on OBR forecast: 4.7% in 2024 and 3.6% in 2025 followed by 2.25% pa – high at 2.5% and low at 2%
- Chart shows rents become “more affordable” in the short-term comparted to a 2024 base as wage inflation is higher than CPI+1%
- Over time, the combined impact of CPI+1% on rent vs wage inflation at lower than CPI+1% implies rent growth faster than wage growth



6.2b Affordability: for tenants and residents

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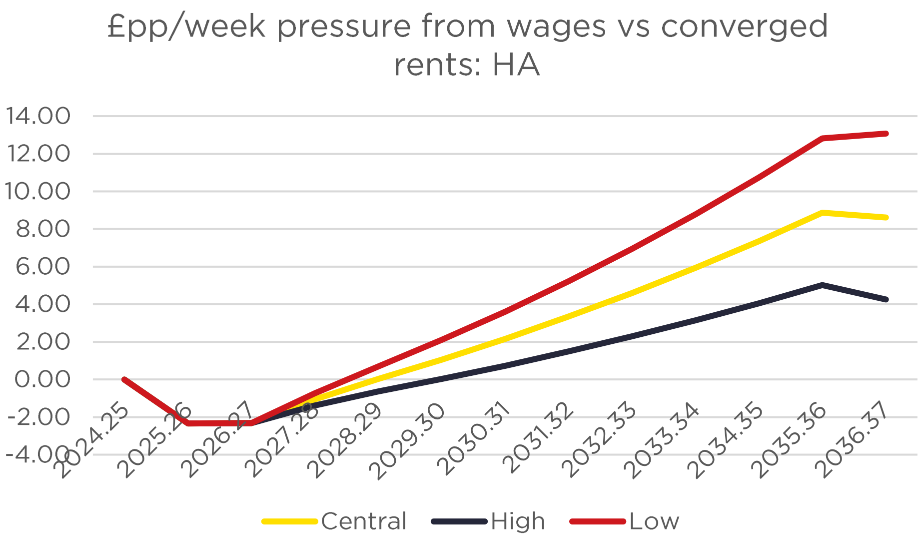
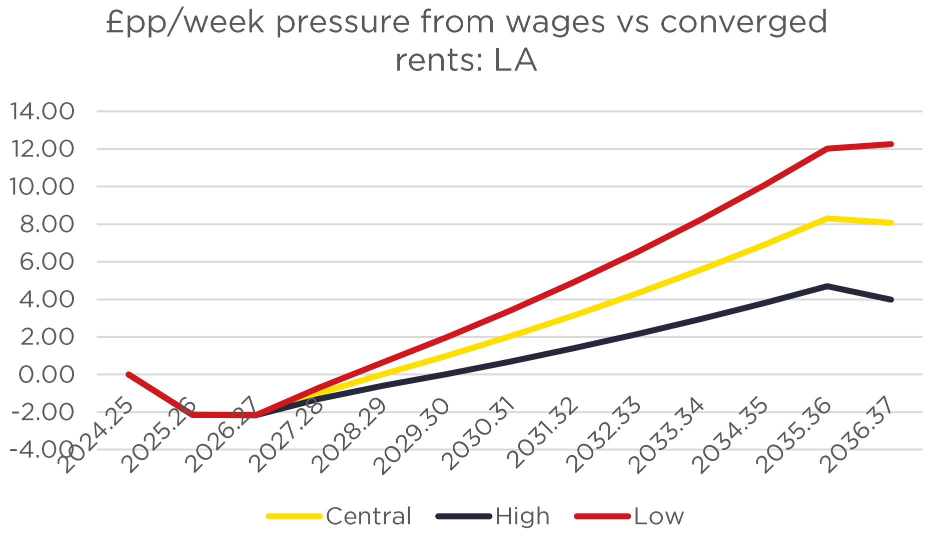
- Wage growth under central/low/high is the compared to growth in rents with £3 convergence to estimate a £/week pressure
- The charts show that:
  - If convergence leads to rents rising at the rate set out, the central wage inflation forecast leads to approx. £8 / week additional income that needs to be found to meet higher average rents over time
  - This is principally driven by rents rising at CPI+1% (3% pa) and wages forecast at 2.25% pa
  - If wage growth is "stagnant" and is the equivalent of CPI, the implied additional affordability pressure is c£12/week by year 10; if wages increase at CPI+1%, the pressure is c£2/week
- However…
  - Higher convergence rents in the short-term are potentially able to be matched by higher than CPI wage inflation – indicating that affordability would not be fundamentally affected by convergence as the convergence-period is in the early year
  - The longer-term pressure on affordability arises from CPI+1% being higher than wage inflation





- The majority of social rents are covered by benefits of some kind
- On the basis that 65% of rents are covered by benefits and that 55% of tenants are fully covered…
- Affordability pressures are focused onto tenants paying some or all of their rent – partial payers will have rent increases covered by HB/UC
- For those paying their rent in full, the additional pressures arising from faster rent increases with convergence amount to less than £2/week by 2030 for less than half of tenants